HUSKY ENERGY

SECOND QUARTER 2020

CONFERENCE CALL TRANSCRIPT

Date: **Thursday, July 30, 2020**

Time: **8:00 AM MT / 11:00 AM ET**

Speakers:

Dan Cuthbertson
Director, Investor Relations

Robert Peabody
President and Chief Executive Officer

Jeff Hart
Chief Financial Officer

Andrew Dahlin
Executive Vice President, Western Canada Upstream

Jeff Rinker
Executive Vice President, Downstream and Midstream

Operator:

Welcome to the Husky Energy Second Quarter 2020 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, Investor Relations. Please go ahead.

Dan Cuthbertson:
Hello, and welcome to our Second Quarter Conference Call. CEO, Rob Peabody, CFO, Jeff Hart, and other members of our senior management team are here to review our second quarter results and take your questions.

Today's call has forward-looking information and includes non-GAAP measures. The identification of the 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 in this morning's news release and in our annual filings on SEDAR and EDGAR.

Unless stated otherwise, all numbers are in Canadian currency and before royalties.

We invite you to save your specific modelling questions for our Investor Relations team after the call. Rob will now begin the review.

Robert Peabody:
Thanks, Dan. Good morning, and thanks for joining us today.

In the second quarter, we saw the full impact of the demand shock caused by the COVID-19 pandemic. Prices and margins were impacted across North America, with extreme volatility at times. In light of the deteriorating macro-environment, we moved swiftly to stabilize the business, by matching our cash outflows with our inflows. This will maintain the strength of our balance sheet in what could be an extended low-price environment.

The actions we took included cutting 2020 capital spending in half by $1.7 billion, targeting about $150 million in cost efficiencies, reducing capital spending at the Superior refinery, and, in conjunction with the Board, lowering the dividend. With these actions, we were able to reduce our total 2020 projected cash outlays by about $2.5 billion, compared to the original plan. We also improved our liquidity position with a $500 million term loan, ending the second quarter with liquidity of $4.6 billion. In addition, we suspended production that was generating negative cash margins, and we made full use of our refining, storage and midstream facilities, to avoid selling distressed production.

Oil prices are ultimately driven by the demand for refined products, and with the Integrated Corridor business, we had a clear window on end-use dynamics. As the COVID-19-related shutdowns began to impact U.S. refined product demand in the first quarter, we adapted our operations by reducing our refinery rates. In tandem, oil production was reduced to remain balanced with the downstream demand pull. We also moved early to draw down our own inventories to create extra space to manage the supply/demand imbalances we could see were going to emerge.

Throughout this period, we have remained disciplined in managing the value chain. The collaboration between the Upstream and Downstream operations in our Integrated Corridor business has been virtually seamless, and allowed us to maximize available value capture as market opportunities arose. For example, by cutting our production to a low level in the second half of March, we avoided negative heavy crude sales at the very low April contract prices. We then entered May at a low production rate, limiting sales at the unfavourable May index price, and as the May spot contract prices improved, we were able to substantially increase production and sell into this rising spot market, capturing the wide spread between May spot and index pricing. More recently, demand for refined products has been recovering. We've responded accordingly, by increasing and optimizing refinery throughput, while also increasing Upstream production. We also recently started steaming the 10,000-barrel-per-day Spruce Lake Central thermal project. First oil is expected later in the third quarter.

We'll continue to be disciplined in matching production with refined product demand. Our agility allows us to make ongoing adjustments in response to market and price signals.

In this challenging environment, we are maintaining our focus on safety and reliability across our operations. This includes a systematic and controlled approach to safety in all areas of our business, and we remain on track to achieve our key process and occupational safety targets in 2020. Year-to-date, we have recorded a 38% reduction in Tier 1 and 2 process safety events, compared to this period in 2019, and 2019, as you'll recall, was a big improvement over 2018. The total recordable injury rate is lower by 31% this year, with a 20% reduction in lost time incidents.

Now, looking at the second quarter, in the Integrated Corridor, approximately 80,00 barrels per day of Upstream production was shut-in at the start of the second quarter. These were primarily heavy oil barrels in our cold, conventional and thermal segments. With demand for refined products recovering, current production from the Integrated Corridor business is around 190,000 barrels per day. Approximately 30,000 barrels a day remains shut-in and the levers are in place to ramp up more in the third quarter, of course dependent on market conditions.

While throughput volumes at the Lloydminster Upgrader were reduced early in the second quarter, they have since been ramped back up in line with increased demand, and at the Lloydminster Asphalt Refinery, operations remained at full rates over the whole quarter, due to strong asphalt pricing.

Our U.S. refineries have also returned to higher levels of throughput. Throughput at Lima is in the range of 145,000 to 155,000 barrels a day, with utilization at both the Lima and Toledo refineries at about 85%.

We are being cautious not to outstrip physical demand and continue to pace our throughput with our product liftings. We expect the path forward to be bumpy and we'll continue to respond rapidly.

In the Offshore, our average overall net production was 71,100 barrels of oil equivalent per day, with an operating margin of $265 million.

In Asia, overall production was 518 million cubic feet per day of natural gas, or 2,246 million cubic feet for Husky's working interest. Associated liquid sales were 23,500 barrels per day, which is just over 11,000 barrels a day net to Husky. Looking forward, the 29-1 natural gas field at the Liwan Gas Project is now mechanically complete. Commissioning work is starting and first production is on schedule for the fourth quarter. Once ramped up, the project will add about 9,000 barrels per day of production net to Husky.

Just moving to ESG and our ESG initiatives, we plan to release our latest ESG report, which will include climate targets, next week.

Now, I'll turn the call over to Jeff to review our Q2 numbers.

Jeff Hart:
Thanks, Rob.

Production and cash flow in the second quarter reflected the severe drop in commodity prices, the shut-in and cash negative production, and the deferral of major projects, including West White Rose and Superior.

Funds from operations were $18 million, and this included a negative impact from the realization of $274 million in after-tax inventory losses that were recorded in our first quarter results, as well as a first-in/first-out FIFO after-tax loss of $3 million.

Cash flow from operating activities, including changes in non-cash working capital, was a loss of $10 million.

Net debt at the end of the quarter was $5.1 billion, up from $4.6 billion in Q1. Importantly, net debt has been stable for the past two months, when oil prices and market demand improved. We will prioritize cash towards the balance sheet to reduce net debt levels.

Liquidity at the end of the quarter was $4.6 billion, which was reinforced by the previously announced $500 million term loan in Q2. In addition, Husky has maintained investment grade credit ratings. S&P recently reaffirmed our BBB rating, and DBRS Morningstar moved Husky to BBB-high, which is still well within investment grade parameters. As Rob mentioned, we have now stabilized our business in this low-price environment by matching our cash inflows to outflows.

CapEx in the second quarter was $310 million. This included $63 million related to the Superior rebuild, which is expected to be largely covered by property damage insurance. CapEx will be significantly lower for the remainder of the year, compared to the first half, as major construction is wrapped up at Spruce Lake Central and the 29-1 field at Liwan. As previously announced, the West White Rose project has been suspended. We expect Q3 CapEx to be in the range of $400 million to $450 million, excluding Superior rebuild costs, with Q4 CapEx between $270 million and $320 million. Moreover, we have the flexibility, should it be required, to reduce our annual capital spending to a range of $1.2 billion to $1.4 billion in 2021, excluding Superior rebuild costs. This is enough to sustain our current downstream throughput capacity at 355,000 barrels a day and hold upstream production at around 260,000 boe per day, allowing the lowest margin production to decline. We'll come out with our 2021 guidance in December, but broadly speaking our capital priorities are focused on our Downstream and thermal operations, with about $1 billion earmarked for the Integrated Corridor.

Looking forward, our number one financial priority in the coming months is to maintain the strength of the balance sheet. Additionally, we are continuing to work on lowering operating costs and ongoing sustaining capital requirements, and have identified approximately $150 million in cost efficiencies to date.

In terms of upcoming turnarounds, the Lloyd Upgrader will begin a scheduled six-week turnaround in Q3, which will include increasing diesel capacity from 6,000 barrels per day to nearly 10,000 barrels a day, and a reminder that this work has been deferred from the second quarter. Tucker will start a four-week turnaround at the end of the third quarter, and in the Atlantic region, the *SeaRose* is now offline for it's regular 15-day maintenance period.

Finally, the Board of Directors has approved a dividend of $0.0125 per common share.

Thanks, and 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 and one on their touchtone phone. You will hear a tone to indicate you're in the 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.

The first question is from Greg Pardy of RBC Capital Markets. Please go ahead.

Greg Pardy:

Yes, thanks. Thanks, good morning. Thanks, guys, for the rundown. Jeff, I wanted to come back to the $1.2 billion to $1.4 billion number, and thanks for some clarity there, but I guess the question is how realistic is this kind of capital number next year, and I hear you in terms of protecting the balance sheet, but obviously there's also the business to run as you get into 2022, so any colour you guys could maybe add around that would be great.

Robert Peabody:

Yes, I'll start and then let Jeff chime in. What I'd say, Greg, is it's very realistic for next year to operate at those levels. Now, what it does involve is that covers—that capital covers all the money we need in the Downstream in order to keep all facilities running, stable and well maintained, and then in the Upstream, the focus then on the capital would be actually on things like sustaining pads for existing thermal projects. One of the advantages we have next year, of course, is that we have finished 29-1 in China. In addition, of course, on the production side, in terms of supporting production at that sort of capital level, we have both 29-1 and Spruce Lake Central that are just coming on-stream at that time.

We've kind of put together the model for that year and it looks like we could run at that sort of level of capital, with production sustained at close to current levels, a little bit down at around—say, maybe around 260 or something thousand barrels day, and that would take us through '21, and we think we also could continue to sustain that into 2022. Of course, at some point here we want to move to a different mode, when the environment supports it, which is—first and foremost, as you know, our first priority is always the balance sheet, so just maintaining the strong balance sheet and ensuring ourselves that sustainability going forward, and then, of course, we want to allocate money to restoring what I would call a competitive dividend for our shareholders, and then, you know, that then opens the door for additional capital spending that could drive growth in future years again.

Jeff Hart:

Yes, Greg, I think the way to think about that, the $1.2 billion to $1.4 billion, is think of it as a call-off on capital and think of it in blocks, as really the focus there is on, for lack of a better term, the core of the Corridor, so you're really maintaining Downstream operations, doing a sustainable—you have sustainable thermal business, and then from there there's decisions, and that's really, if you look at it—like Rob talked about in Asia, where we're at with 29-1 being complete, mechanically complete, that's really focusing on a sustainable Integrated Corridor, and then from there, you know, there's further decisions. Yes, it is sustainable.

Greg Pardy:

Okay. A big chunk of this comes out as a result—on capital, anyway, is coming out, because you've laid down West White Rose. What would be the earliest that you'd look at resurrecting West White Rose, do you think?

Robert Peabody:

Yes, Greg. We have, and we continue to have, work suspended at West White Rose. Over the course of the third quarter, we're going to be examining the future plans for the project and what our game plan is going to be around it, and we'll provide an update when we finish that work.

Greg Pardy:

Okay. Just as follow-up, but switching gears, you guys are adding 1.5 million barrels of storage, I guess, at Hardesty at year end. Just curious as to whether that's commercial. Then, I know you've got another 4.4 million barrels between Hardesty and Lloyd. Is all of that operating, or commercial? I'm just trying to get a sense as to the thinking behind adding the capacity.

Jeff Hart:

Yes, Greg, and I'm assuming you're talking to the projects we referenced in the Midstream partnership.

Greg Pardy:

Yes.

Jeff Hart:

Really, that's not all just—that's through the joint venture, it's not all Husky-dedicated storage, there's third-party storage, as well, in there. I wouldn't look at it as it's all incremental to Husky. It's roundabout—I think it's about half, but I'll go back. But, effectively, it's the infrastructure investing, operational storage to support us and third-party commitments.

Greg Pardy:

Okay. It's operating as opposed to commercial?

Jeff Hart:

Well, you can kind of, you can do—with operational inventory, any storage, obviously, we can make commercial decisions around and optimize.

Greg Pardy:

Okay, okay, and maybe just—this is a request or just an observation. I know in the last quarter you'd made the switch in terms of disclosure, and so forth, so here's the request, because I can tell you our model is in less than ideal shape right now and the thing we really, really need as we boil through everything is just basically a netback for your bitumen and heavy oil on a dry barrel basis, i.e., not gilded. It is causing us no lack of frustration, to try to get the numbers working, so anything you guys could do there would be much appreciated.

Jeff Hart:

Oh, absolutely, we'll take that. Obviously, it was a big change, I think, for everyone, both internally and out in the market, to realign, to get everything to the Corridor and Offshore, but definitely we'll take that feedback. We put some enhancements in this quarter and we have the information, so we'll take a look at that, Greg, and make sure we cycle back, because we want to make sure that everyone's getting the proper information. This is continuous for us, and we'll continue to move it forward.

Greg Pardy:

Okay, and just specifically for Q2, if we had certain questions around just basic stuff, how much did you get for bitumen, how much did you get for heavy oil, can we fire that into IR and get an answer for this quarter?

Jeff Hart:

Absolutely, yes.

Greg Pardy:

Ah, you're a rock star. Thanks so much, appreciate it, guys.

Operator:

The next question is from Emily Chieng of Goldman Sachs. Please go ahead.

Emily Chieng:

Good morning, guys. My first question is just around, again, the next couple of years of capital spend outlook, and then trying to square that against your 2019 Investor Day five-year growth plan. I know last year, and we haven't had the Analyst Day yet this year, but CapEx was obviously expected to be in sort of the $3 billion plus type of a range, that's now a lot lower, and I think the production goal at the end of the five years then was 400,000 barrels per day. Maybe, can you just provide some colour as to what's changed between those two data points, and is there still the goal to reach that 400,000, or some higher level of production at some point in time?

Robert Peabody:

Yes, thanks, Emily. The way I would think about that, again, is, of course, what changed was COVID-19, I think, and the outlook for product demand, and of course oil and gas prices. Husky's always been a company that is going to prioritize its balance sheet in tough times, because we want to ensure we always maintain our investment grade credit rating and we always are in good shape for when these conditions eventually pass.

What I'd say in terms of the production goal and the way to think about production at the moment is, you know, we did have a goal, we said, look, against the $60 price assumptions, we have the resource base, we don't see a problem with the resource base in order to continue to deliver projects and growth options to get to 400,000 barrels a day. However, with the lower pricing, again, we prioritize the balance sheet. Again, I'd just say the way I'm looking at this right now is that we're going to ensure that the balance sheet remains stable and strong, and that's going to be the first use of all cash coming into the Company.

Then, I think, as we go forward from there, we'll strongly prioritize making sure the dividend becomes more competitive with—not more competitive so much in our industry, since the whole industry's dividends are dropping a lot, but more competitive with what—I always say, look, we're a mature industry, we should be paying a dividend, and it should be a good dividend, and we'd like to get back to that, and then, as pricing allows, then we would start bringing back those options to start increasing production again.

That's the way we're thinking about that.

Emily Chieng:

Great, that's super-clear, and just one follow-up is just around some of the operational cost savings that you've seen to date. Relative to expectations, anyway, you guys did a lot better on the OpEx front. How much of this can we carry forward and how much is more one-time in nature?

Jeff Hart:

Yes, no, Emily—it's Jeff here. We are cognizant that the 150 that we're putting out there, is we really view that as sustainable savings here. There's other things that we're working through on, obviously deferrals and interim pieces, but the way to broadly think about that is, as I say, a third is really focused on our onshore Upstream in the Integrated Corridor, really aligning and getting efficiencies on how we operate in cold and Western Canada and streamlining that. On the corporate side, I'll say just about a quarter of those overall savings have really come from optimizing our IS infrastructure rate reductions and just getting efficient there and make sure we get the best dollar out of our IS and corporate dollars, and then the remainder is really spread through Atlantic and Downstream on rate reductions, efficiencies, logistics and the like. We do view it as sustainable and we'll continue to work it.

Emily Chieng:

Thanks, I appreciate the colour.

Operator:

The next question is from Danny Wong of Morgan Stanley. Please go ahead.

Danny Wong:

Hey, good morning, guys. Thanks for taking my questions. My first question is really around the I&M part of the business. I think, historically, you've broken it out. Now, going forward, you have it embedded within your operations. Just wanted to get a sense in terms of how much of that part of the business contributed to results, which came in a little bit better than what we were anticipating, and if you're able to parse it out, how much did that—or even quantify that benefit for the quarter.

Jeff Hart:

Yes, Danny, we'll come back with the details with you, but when you think about it broadly, is, obviously, with the heavy dips that we saw in Western Canada, obviously, the margins on Keystone would've have been impacted by that, just simply because the Canadian heavy differential was fairly tight. Obviously, that was more value attributed, obviously, into the Lloyd value chain, because more of that value was generated in-basin, in essence, and it would be much the same with our export capacity in natural gas out of Western Canada. You'll see that, really, both of those, in the marketing and other, in those segments. The way I think, most of that value is really driven by our export value and differentials between Canada and the U.S., and all the ultimate end markets, and, really, I'd say were not a big drive in value, given we saw production come in and actually the basin differentials tighten up, and so most of that value was actually in-basin, and look at that marketing and other, and, really, that's where we have our inventory valuations and the trading or the export pipelines.

Robert Peabody:

Do you want to add anything to that?

Danny Wong:

Great.

Robert Peabody:
Okay.

Danny Wong:
Great, thanks for the colour there, that was very helpful. My second question is really more of a strategic, longer term question. Obviously, as we're emerging from this COVID downturn, just curious in terms of how you're thinking about how you might run the Company a little differently going forward. I think a lot of it will probably be related to the operational side, but also curious in terms of how you might think about your financial side, as well. I'm just trying to get a sense if there's any incremental challenges, or even opportunities, that come out of this going forward.

Robert Peabody:
Well, that's a good question, a rather broad question. One thing we're going to do is we're going to capitalize on all the learnings that we've gotten through, again, another stress test of the business, and that—we had an earlier question about retaining cost savings, so a big, big focus is going to be on how do we make sure these remain structural cost savings and we don't go backwards.

Some of the things that we've been doing, which are pretty fundamental on the operational side, is we've looked really hard at, you know, especially our more remote operations. If you think about the *SeaRose*, if you think about our oil sands project, where we have a certain amount of operating staff that are housed onsite, the logistics of getting them back and forth is quite expensive, the allowances that need to be provided to those people are quite high, and so we have been able to fairly radically reduce the number people on-site in these operations and provide much more service from the centre. That is something that—it actually yields quite material cost savings, and I don't think we'll be going backwards on any of those things. Those are some of the operational lessons.

We also, in the cold heavy oil business, put a whole new different operating model in place, with a lot more central control of everything that goes on in that operation, and again, it really made a step-change in the costs in that business. Again, I think that's structural and we won't be going back on that.

The first thing is to do that. Of course, I think us, along with almost every other business in the world, is learning there may be some additional savings can be achieved through the new technology that allows people to work from home or work from various locations still quite efficiently. Again, one of the things we'll be doing in the next quarter is we're evaluating exactly what the lessons that we're learning there are, to see if there's a lower cost model, as well, going forward in terms of efficiencies.

Those are some of the things we're looking at going forward. There's probably more to your question than that, but that's probably what I would offer at the moment.

Danny Wong:
Thanks for the thoughts. Just curious, on the financial side, is it worth re-thinking in terms of what's more an appropriate leverage level, cash usage, things like that? Has there been any thought on that side at all?

Robert Peabody:
I think Jeff can probably answer this more fully than me, but I'd say, look, we're—our focus has for years and years always been on maintaining investment grade credit ratings. Interestingly enough, I guess my takeaway on that, I'd say is in this industry, having an investment grade credit rating is very important, particularly in the businesses we're in, so I think that still is going to remain our focus. It's served us incredibly well over decades, since we've really started focusing on that, and it ensures you're always a survivor at the end of these things and you can come back.

One of the things that's going on here in the background, as painful as all of this is, is ultimately the competitive dynamics in the industry are improving. Unfortunately, it's happening through a lot of pain and companies disappearing, and things like, but coming out of this, I'm still absolutely convinced, the numbers tell you there will still be substantial hydrocarbon demand for quite a number of years, but the number of players in the industry is going to reduce and the competitive intensity, I think is ultimately dropping, which I think are good signs for the remaining companies in terms of their ability to be profitable long term.

Danny Wong:

Thanks, Rob, appreciate your thoughts.

Operator:

The next question is from Phil Gresh of JP Morgan. Please go ahead.

Phil Gresh:

Yes, good morning. I apologize if this is maybe somewhat redundant, hopefully not, I'm hopping between calls, but the commentary around the CapEx for next year, is that essentially contingent on a $40 type of strip price scenario, that we're seeing today, and if it were lower or if it were higher, is there any thinking as to how you would potentially adjust that in either of those cases, or is that just basically the floor level and if prices go up you'd try to use any excess cash, say, for the balance sheet or something else?

Robert Peabody:

Broadly speaking, answering that question, I'd just say, look, that capital number we put out there is for an environment that looks a lot like today, or a lot like the last quarter, I think is the way I would describe it, and if we saw substantially higher prices, then we have great opportunities to deploy some additional capital, though, again, I put that in the context that first we want to ensure we've got the sustainable balance sheet and, second, we're conscious that it'd be nice to give shareholders a little bit more money back every quarter, but there are things we could invest in there. In terms of if the price is lower, of course, you can take capital lower than that for short periods of time, but you will see the impact on production going forward as you take it even further down from that number.

Phil Gresh:

Okay. Then, in the higher scenario, I guess it's fair to say it would be more shorter-cycle thermal and that you'd need to see a more significant or sustained price recovery for West White Rose, or how do you think about that?

Robert Peabody:

Yes, I think, actually, as you look across the portfolio now, especially with the completion of

29-1, most of the capital that we spend is going into relatively short-cycle projects, with the only real exception being West White Rose, although it's got a certain—it is about 60% or so complete, so it's not like you're starting from square one, so it's not a long, long cycle project. However, as I said earlier in the call, we're going to be doing work in this quarter to understand what our game plan is going to be around that project.

Phil Gresh:
Sure, okay. My last question, just if you could remind me—with the Asia gas contracts, I believe there's a price re-opener potential in 2021, I think maybe later in the year—if you could remind me how that structurally works and what the possible, I guess, range of adjustments could be? I think it's only a certain range of potential price adjustments.

Jeff Hart:
Yes, it's Jeff here. I wouldn't classify it, really, as a re-opener. It's just the pricing opens up to a small range in collar after this five-year frame, so it's not a re-opener, and you've got to think, because right now you're probably in and around a ballpark like $11, so a range between $9 and $13 at the point of this. It's not a re-opener, you're living within a small band, and it just is standard in what we have in the agreement.

Phil Gresh:
Yes, okay. Thank you.

Operator:
The next question is from Prashant Rao of Citigroup. Please go ahead.

Prashant Rao:
Good morning, and thanks for taking the questions, a couple of specific ones here, if you don't mind. Lloyd, the heavy value chain, of course, op costs across the board, you've brought down quite a bit, but the step-down there seems to be fairly material, and I just wanted to make sure, given the restructuring of the reporting structure, get a sense of how much of that was organic versus could any of that potentially be reclassification, just as we think about carrying forward some of that strength in the segment from cost reductions. It seemed particularly strong in the quarter, so any colour there would be helpful.

Jeff Hart:

Yes, I'll start and Andrew and Jeff can further opine. But, yes, the Lloyd value chain, I'd say there's a few things in there. Number one is realignment and reassessing all of our cold heavy oil production. We've changed our operating model, really centralized and just streamlined it, and that savings, you really start to crystalize here in Q2, and the refocus, and then on top of that, the one thing, as we discussed in our—as we went through the script here, is, effectively, we did cut back production in our thermal operations, so you'll see a little bit of that, that's a little bit transitory as you're bringing down the production, and we also just adjusted the Upgrader rates down a little bit in the Q, as well. A lot of those are sustainable. Some of them will come back with production as we ramp on the thermals.

Robert Peabody:

But on a unit basis, they should be very sustainable.

Jeff Hart:

Yes.

Andrew Dahlin:

Yes, absolutely, and maybe I can just—this is Andrew Dahlin speaking—just add a little bit of colour, for example, on the cold. The benefits of the step-change we've made, I mean, if you go back to last year, unit operating cost—to build on Rob's point—unit operating cost in our cold business was in excess of $30 per barrel. The step-change we've now made in this operating model has taken our operating cost at the moment down to about $25 a barrel, and we're outlooking around the mid-20s in go-forward operating cost, very much reinforcing Jeff's message that these costs are structural and they're sustainable.

Prashant Rao:

Okay, that's very helpful, thank you, and just a quick follow-up. The price realizations in the Offshore—and, obviously, price realizations were weaker on a year-over-year basis, but seemed to hold up a bit more resiliently versus our expectations. Again trying to gauge the strength there and how much to read into sort of how much of that continued into 3Q, and any colour as to what could be structural in terms of that market and what you're getting in price realizations would be helpful. Thank you.

Jeff Hart:

There's nothing structural. What you saw in the quarter, much like we saw in the crack environment and some of the discounted pricing in the Integrated Corridor for the Upstream, is we did see the realizations that come off of Brent a little bit just in this environment, because, obviously, there was excess of production as the market was rebalancing, but nothing structural. I'd expect our realizations, relative on the liquid side, to continue back to where they were aligned as historical trends with Brent.

Robert Peabody:

Yes, and then if you look at the overall realized price, I mean, they did benefit by strong liftings in the Asia-Pacific region, and we do get very good pricing there, and so the high volumes flowed through and helped realizations in that part of the business.

Prashant Rao:

Okay, that's clear. Thank you very much. I'll turn it over.

Operator:

The next question is from Manav Gupta of Credit Suisse. Please go ahead.

Manav Gupta:

Hey, guys. I'm sorry if you already addressed this, but I just wanted a quick clarification. When I look at il Sands and the diluted bitumen, the operating margin improved almost $20, while costs were down. Was this basically a function of condensate purchase lag which kicked in, which allowed you to improve on the operating margin quarter-over-quarter, although the benchmark declined over there?

Jeff Rinker:

Yes, Hi, Manav. This is Jeff. Can you hear me okay?

Manav Gupta:
Yes, sir.

Jeff Rinker:
Great. This is Jeff Rinker. Maybe I'll just speak to that a little bit. We did talk earlier about the former I&M segment, which is now embedded into the Integrated Corridor, and I think it's important to recognize that part of the reason why we had quite good realizations on the heavy oil in the Integrated Corridor this quarter was because of performance across the whole integrated value chain, which, of course, brings netback back to the heavy oil barrel, but just because you don't see I&M split out separately anymore, there's still quite a lot of good activity going on along that value chain.

In particular, in the second quarter, we saw quite a lot of—well, it's an understatement to say we saw quite a lot of volatility. There was tremendous volatility in the condensate price, as you mentioned, and the flat price, and all of the differentials and spreads that we deal with, and it did create for us some opportunities along the Corridor. I think if you just look at—if you modeled only the flat price, the indexes and the spreads, you would come to a lower netback than what we actually realized, and some of the reason we improved on that, or we did better than that, is because we were able to make some storage plays, some swap plays, some changing of crude that we shipped on the pipeline, and really used our integrated value chain assets along the way to add to the netbacks that we received for the heavy oil.

Manav Gupta:
That's very helpful. Second question. Within your refining system, what are you seeing in terms of the demand that specifically relates to the areas where you are selling your product? What's the trend—3Q versus 2Q, what kind of improvement are you seeing quarter-to-date versus the last quarter?

Jeff Rinker:
Yes, so this is Jeff again. I think, when I look at the statistics for the overall motor fuels demand in the U.S. and the Lower 48, we were pretty lucky in our location of our refineries. The U.S. Midwest never suffered quite as deep a demand destruction, I think, as the coasts did, even the depths of the trough back in April and May. Still, we had our refineries turned down to the 60%

level for a time. Since then, we've come back, we're now running in the 80% and 90% utilization rate, which I think is a bit on the high side for the overall U.S. refining complex right now.

For third quarter, Manav, your guess is as good as mine. We're watching very, very closely the traffic patterns in the U.S., traffic patterns in our markets. We seem to be right now stalled in that 80%, 90% range and we're hoping demand continues to recover, but we're really very closely watching demand, and we're going to calibrate the whole refinery throughputs and, really, the throughput of the whole integrated value chain, to where demand is and not get ahead of ourselves, so we get caught with stock builds that we can't place economically.

Manav Gupta:
The last question on my side is, when you are running your internal models, assuming a $40 WTI and whatever differential, how confident are you of generating a surplus free cash flow in 2021, at this point of time?

Robert Peabody:
I think they've done a little bit of that. I think the answer is, if the forward strips play out, then we're quite confident.

Manav Gupta:
Thank you. Thank you, guys.

Robert Peabody:
Thanks.

Operator:
This concludes the analysts 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, you may press star and two.

Our first media question is from Chris Varcoe of The Calgary Herald. Please go ahead. Chris, your line is open.

Chris Varcoe:

Hi, I have two questions. Rob, the first one deals with the 30,000 barrels a day that is still shut-in. What do you need to see in order to bring that oil output back online and when do you expect that might happen? Then, separately from that, is there concern, with all the oil coming back online here in North America, that it's going to start to impact prices? That's my first question.

Robert Peabody:

Well, the answer has to be, in general, on the 30,000 barrels per day, I mean, that's shut-in, because if we brought it on right now—it's a bit of a combination. It's mostly because, with the price we're seeing right now, most of that would not contribute cash positive free cash flow to us if we brought it on, so we just do those calculations on an ongoing basis, and that's the basis we make. On top of that, the other consideration, as I say, is just, as Jeff actually said earlier, is looking at end use product demand. Even in the short term, if we think we could generate an extra amount of cash at the margin on some of those barrels, if we think that the market is not going to be able to absorb them, well, then, based on what we're seeing in the downstream, then we'll hold them and keep them shut-in for—until we're more comfortable that the market can absorb them in a good way.

Chris Varcoe:

My second question has to do with—I guess I'm wondering what signal do you think it's sending this week when you hear the news of Deutsche Bank saying they're no longer going to fund the oil sands, or even the news yesterday that Total has taken a large write-down and believes that its Canadian oil sands production at Surmont and Port Hills are stranded? I guess, what kind of signal do you think that's sending to the market and to the industry?

Robert Peabody:

Well, first, let me just say I certainly was disappointed with the Deutsche Bank position, and, again, probably like the Premier, I think it ignores the facts and it ignores all the tremendous work that's going on in the industry to lower emissions intensity, as well as our aspirations of an industry, which I think we're making great progress on, to ensure that the oil from the oil sands is just as competitive from a carbon-intensity point of view of any other sort of supplies that you can get after. Very specifically, it doesn't affect Husky. We don't do any business with Deutsche Bank at the moment, and haven't for a long time.

The other thing I'd just point you to is Husky is going to be releasing its ESG Report, I think next week now. It's going to contain our targets for lowering emissions intensity going forward, also some other targets around diversity, and then cover the whole spectrum of ESG issues, and again remind everybody that, while people talk about ESG and people get focused on carbon intensity, in almost all other ESG metrics, Canadian production is light years ahead of most production around the world. It benchmarks at the very top of ESG metrics. Certainly, we'd like to invite all lenders, investors, stakeholders and the media to review the ESG performance report when it comes out next week and let us know what they think.

Chris Varcoe:
But, more broadly, does it send, I guess, a negative signal, do you think, about people looking to invest in the oil sands, when you see things like what Total did yesterday?

Robert Peabody:
I can't really speak to Total, in particular. From a very parochial viewpoint, I guess, I look at it as less competition in the sector and good for us in the long term, in terms of profitability, and I guess if other people see that as a negative sector, that'll only add to that sentiment.

Chris Varcoe:
Thank you.

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, for your questions, really appreciate your participation today. I'll sum up by saying that we continue to focus on improving our resilience in what are really unprecedented times, and we are working to further improve the sustainability of our base business, and this

includes staying disciplined in the Integrated Corridor to keep Upstream production in step with product demand and take advantage of optimization opportunities as they arise.

Just a reminder that we have two new projects coming on-stream in the second half of the year, Spruce Lake Central and the 29-1 field at Liwan. Both of these projects, at current pricing, will contribute to free cash flow, will add to free cash flow, further enhancing our resilience.

All together, we're maintaining our capital discipline and preserving our financial strength, which will position us well for an eventual recovery of the global economy.

Thanks again for calling in today.

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