



HUSKY ENERGY

THIRD QUARTER 2016 CONFERENCE CALL & WEBCAST TRANSCRIPT

Date: Thursday, October 27, 2016

Time: 10:00 AM MT

Speakers: **Asim Ghosh**
President and Chief Executive Officer

Jonathan McKenzie
Chief Financial Officer

Robert Peabody
Chief Operating Officer

Dan Cuthbertson
Director, Communications and Investor Relations

OPERATOR:

Welcome to the Husky Energy Q3 2016 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, simply press star, and one on your touch-tone phone. Should anyone need assistance during the conference call, they may signal an Operator by pressing star, and zero on their telephone.

At this time, I would like to turn the conference over to Dan Cuthbertson with the Investor Relations Team. Please go ahead, Mr. Cuthbertson.

DAN CUTHBERTSON:

Hello and thanks for joining us this morning. I'm here with CEO Asim Ghosh, COO Rob Peabody, CFO Jon McKenzie, and Bob Baird, our SVP from Downstream. We'll go over our third quarter results and then open the line for your questions. Please feel free to direct any detailed modelling questions to the Investor Relations group following the call.

A reminder that today's call includes forward-looking information. The various risk factors and assumptions are provided in this morning's news release as well as on our website and in our annual filings on SEDAR and EDGAR. All figures are in Canadian dollars and before royalties unless otherwise stated.

Asim will start us off.

ASIM GHOSH:

Thanks, Dan and good morning everybody. As October draws to a close we are well into our planning mode for 2017 and to state the obvious, over the past two years there's been persistent volatility in oil prices, periods of lagging demand, growing inventories. In light of this, here's how we are thinking about the business going forward.

Several key elements will continue to guide our strategy including the maintenance of a strong balance sheet which has always been a hallmark of Husky. We view this as a buffer and a source of stability, especially in this new oil price era. At the beginning of this year we set a target to reduce our debt to the \$4 billion range. We met this objective in the third quarter and our debt metrics are now amongst the best in the industry. Looking to next year, we'll maintain

the strength of our balance sheet by living within our cash flow, however the difference is as a result of our successful efforts to lower our costs and increase our productivity, we are now in a position to deliver consistent growth and margin expansion in the current price environment. Next year's plan will reflect this shift. In addition, we will continue to invest those projects that offer resilient, longer life production with lower operating costs and reduced sustaining capital requirements.

We set a goal, you'll recollect, to have at least 40% of our production generated by these types of projects by the end of 2016. We have achieved that target a few months ahead of schedule. In fact, we've hit a significant milestone in that our overall thermal production including Tucker, Sunrise, and our Lloyd Heavy Oil Thermals has risen from about 22,000 barrels per day in 2010 to more than 115,000 barrels a day today, which means that over half of our liquids production is now coming from thermal productions in one form or another. Our three new Lloyd Thermal projects are contributing to overall Lloyd and Tucker Thermal netbacks of around \$20 per barrel in the past quarter.

In our Lloyd portfolio alone we have plenty of runway as we have identified numerous projects that can add an additional 150,000 barrels per day of higher quality thermal production over time.

With regards to Liwan, we have finalized a new commercial agreement that gives us attractive gas price over the expected 20-year life of the first two fields, and also locks in a steady income stream not directly exposed to oil prices.

To sum up, we continued to advance our objectives in the third quarter. We fortified our balance sheet and are growing a more resilient business. Our program next year does not rely on an oil price recovery, but will be built on the solid fundamentals of maintaining a strong balance sheet, continue to live within our cash flow means and providing a pathway to growing what we've called higher quality production. We'll speak to that more on our guidance call in December.

One additional item, I have announced that I'll be retiring in December. I'd like to think that some of you are saddened by the news and others may share the same sentiment as my family that it's about time. My personal hope of course is that they're more in the first camp than in the

second. The past seven years here at Husky have certainly been challenging but for me I would also say extraordinarily satisfying. The vitals of the Company have never been healthier as we start to emerge from this unprecedented drought. We have a rock-solid balance sheet, a clear path ahead, and a culture of delivery. While many CEOs would like to take this opportunity to say they have worked with a great team, in my case that certainly is a very heartfelt sentiment.

I'm handing over to Rob and the Senior Management with a high degree of confidence they'll be good stewards of Husky's next stage of growth. My recommendation to promote Rob was accepted by the Board with unanimity and I am delighted with that.

Jon will now walk you through our Q3 financial picture.

JONATHAN MCKENZIE:

Great. Thank you Asim, and good morning. As Asim mentioned, we have met our debt objective. We closed the Midstream transaction and most of the outstanding Western Canadian dispositions with the proceeds applied to the balance sheet

Net debt at the end of the third quarter was \$4.1 billion compared to about \$7 billion at the beginning of the year. We have \$1.4 billion in cash on hand in addition to \$4.7 billion of credit facilities of which \$4.2 billion remains undrawn, and we have no long-term debt maturities until 2019.

In terms of how we are tracking against our 2016 objectives, with production we still expect to come within our guidance even with the sale of more than 27,000 barrels a day in Western Canada. With CapEx, we expect to finish this year at \$2 billion, about \$100 million below our stated range of \$2.1 billion to \$2.3 billion. Even with the reduced level of spending, we expect to fully complete our planned program and some additional items as well. This reflects our ongoing cost reduction program which included significant procurement savings and improved productivity.

Now turning to our Q3 results, Upstream production averaged 301,000 boe per day compared to 316,000 boe per day in the second quarter. This takes into account the Western Canadian

asset sales as well as reduced volumes at the Liwan Gas Project and a turnaround at the Sea Rose FPSO. This was partially offset by increased Thermal production.

Throughputs at the refineries and the upgrader averaged 320,000 barrels per day which takes into account the wrap up of the planned maintenance work at Toledo. WTI prices averaged US\$44.94 per barrel compared to US\$46.43 a year ago. Average realized pricing for total Upstream production was \$33.11 per barrel, down from \$39.45 in the third quarter of 2015. This was primarily due to wider heavy oil differentials and an adjustment in the third quarter to reflect the effective date of the revised Liwan agreement. This had an impact to the overall realized price of about \$1 per barrel in the quarter. Upstream operating costs were \$15.15 per barrel.

In the U.S., Downstream, the Chicago 321 crack spread saw continued weakness in the quarter, averaging US\$14.29 per barrel compared to \$23.87 a year ago. U.S. realized refining margins were US\$7.34 per barrel compared to \$8.10 in a third quarter of 2015. This was due to a couple of factors. The price of RINs, which are at the highest we've seen in several years were about \$34 million in the quarter and the ramp-ups of the refinery throughputs following our major turnarounds in the U.S. Refining.

We saw continued steady performance from our Canadian Downstream operations. Asphalt margins came in at \$22.99 per barrel and upgrading margins were \$17 per barrel.

Cash flow from operations was \$484 million compared to \$674 million last year. This includes a pre-tax FIFO loss of \$64 million and a \$34 million cost for our RINs exposure. CapEx in the quarter was \$309 million and we saw \$175 million in free cash flow.

It's important to note that not included in our reported cash flow is \$146 million in cash that was received as a pre-payment for our gas volumes at Liwan. This is recorded as deferred revenue on the balance sheet.

Net earnings were approximately \$1.4 billion which takes into account a couple of significant items. The \$1.3 billion in gain we realized related the Midstream transaction and \$167 million after tax associated with the closing of additional Western Canadian dispositions. The adjusted net loss was approximately \$100 million.

Now I'll turn the floor over to Rob to review our operations.

ROBERT PEABODY:

Thanks Jon. We made steady progress across our portfolio during the quarter and I'll just touch on a few highlights. Starting first with our Heavy Oil business, and before I get into the detail, the headline from this business unit is that we hit our 100,000 barrel per day Thermal production milestone well ahead of our schedule.

As you know, we have brought on three new Thermals this year: Edam West which we brought on near the end of August, achieved its 4,500 barrel per day design capacity in October and is continuing to ramp up. Vawn, which started in mid-May hit its 10,000 barrel per day design capacity in September and it is also ramping up higher. Edam East, another 10,000 barrel per day project that came on production in April is now running at more than 15,000 barrels per day.

At the Tucker Thermal Project, we averaged about 20,000 barrels per day in the third quarter and we're progressing work that will see that production rise again in late 2017.

On the horizon, site preparation work is progressing at Rush Lake 2, another 10,000 barrel per day project that is slated for first production in 2019. In addition to Rush Lake 2, we are assessing another 17 Heavy Oil Thermal projects, representing about 150,000 barrels per day which can be brought on over time. This includes three 10,000 barrel a day projects that we expect to sanction soon.

In Western Canada, we made significant progress in the restructuring of our conventional Oil and Gas business. By high-grading our portfolio to focus on fewer more material plays, we expect to achieve greater capital and operational efficiencies. It's interesting to note that more than 27,000 barrels per day that we sold this year has been replaced almost barrel-for-barrel with new, lower cost, higher netback, long-life Lloyd Thermal production. This is a good example of how we are continuing to transform Husky.

Turning to the Downstream, Jon mentioned earlier that we wrapped up our turnaround work at Toledo. The units were brought on gradually over the quarter and we have now increased the amount of high-TAN crude we can run to about 65,000 barrels per day, enhancing the

profitability of this asset. For each barrel of high-TAN we can run versus the traditional feedstock, we save about \$3 to \$4 a barrel on those feedstock costs.

At Lima, the first stage of our crude oil flexibility project is complete and we are running at over 8,000 barrels per day of heavy crude feedstock which is about three months ahead of our original schedule. I'll remind you that the full scope of this project is scheduled for completion in 2018 when we'll be able to run up to 40,000 barrels per day of heavy. This increases the margin capture of the refinery, improving its competitive position.

In regards to our Asphalt business, we have started pre-feed work on a potential 30,000 barrel per day expansion of our refinery capacity in Lloydminster. It's clear that the business is continuing to show strong returns and can provide an additional outlet for our Lloyd Thermal production, which is an ideal crude for making asphalt. We'll have more to say on this after the work is complete.

In the Asia-Pacific region, gross production from the Liwan Gas Project averaged 220 million cubic feet per day with associated liquids at approximately 10,600 barrels per day. The second subsea pipeline has now been installed at Liwan to provide additional operating flexibility and redundancy over the life of the project.

In the Madura Strait, offshore Indonesia, the BD Field infrastructure is taking shaping and is approximately 90% complete today. The field is on schedule to start up production next year. Three additional Madura fields are being progressed towards first production in the 2018/2019 timeframe.

Looking at Sunrise, the project is ramping up following the extended shutdown caused by the wildfires in Fort McMurray. Gross production is currently running at about 33,000 barrels per day and SORs are continuing to trend towards our target rate of three.

As you may know, low-pressure reservoirs recover a little more slowly after a cold restart. Following the fires, initial production came on quickly and levelled out during August and September as we went through the process of rebuilding reservoir pressure. At this point about 50% of the ultimate steam chamber height has been achieved and production will steadily increase as the steam chambers continue to grow.

Finally, in the Atlantic region, the Hibernia Formation well beneath the main North Amethyst field was successfully drilled and we achieved first oil in early September. The well recently reached its expected net production rate of 5,000 barrels per day. Meanwhile, the Henry Goodrich has spudded a third in-fill well at South White Rose. As we have mentioned earlier, we have at least four additional in-fill wells planned to further support near-term production at White Rose, and the potential for another five beyond that.

In terms of West White Rose, the assessment is progressing with the focus on increased capital efficiency and improved resource capture.

Thank you and I'll now turn the call back to the Operator.

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 touch-tone phone. You will hear a tone indicating you're in queue. For participants using a speaker phone, 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 today is from Frank McGann of Bank of America Merrill Lynch.

FRANK MCGANN:

Good day. Just two questions if I might. One just in terms of the M&A side of the story. You obviously have a fairly deep portfolio. It sounds like you would be obviously prioritizing that in terms of growth going forward. Does that mean that it's very unlikely you would look at M&A or is that something that still could be a possibility if properties become available?

Secondly, just looking at the cost side of the story, you've made significant progress. How much do you think is still left to be achieved or are we moving more into a steady-state environment given what seems to be a little bit more stable oil price environment?

ASIM GHOSH:

Frank, let me take that one by one. When it comes to M&A, I think I've said before and I'll say again we have looked at several opportunities in the past and for us it's a very simple discipline. Any M&A target must meet the same benchmarks as what we can do organically internally. One of the unique situations we've had at Husky, it's a problem with respect to M&A but it's a terrific problem to have in terms of opportunity is that we are relatively uniquely positioned in terms of Husky in terms of organic growth opportunities which will be very accretive at very low oil prices. I've said this before; we set ourselves a very tight target. Any project we invest in in Upstream must break even at \$35—fully-loaded breakeven like including BD&A (phon 19:40) at \$35 Brent pricing and must make a 10% return at \$45 Brent pricing and we have many such opportunities.

That's with respect to M&A, so yes, we've looked before, we will continue to look. We have a very open mind to do anything that's transformational but it must chin the bar off beating our internal opportunities.

Now, cost structure, this was—this year actually, the second half of this year is been where we've reached critical mass in terms of changing the cost structure, okay? However, however, the satisfying thing for me is that this is not like a journey where you kind of, hey, you end of a race, you touch the tape and it's done. The good thing is we see continued significant opportunity ahead and that will continue to come and that has stopped (phon 20:38) at, you know, in the fullness of time both with the guidance call next year in December and the Investor call next year, we will continue to, in a disciplined way, keep you guys updated as we have already done. As we've always done I should say.

FRANK MCGANN:

Okay. Thank you very much.

OPERATOR:

The next question is from Mike Dunn of GMP FirstEnergy. Please go ahead.

MIKE DUNN:

Thank you. Good morning, folks. A couple of questions from me. Maybe first on Madura BD. The project is almost complete here. You haven't nailed down the range of timing of first gas

there other than to say next year. Can you give us a bit more on that? I think in our model we've got it sort of mid-year or springtime coming online.

ASIM GHOSH:

Yes. I think we've said in the past mid next year, if I remember right, but I think, you know, that's the sort of timeframe I think I'd be working towards, yes.

MIKE DUNN:

Okay. Thank you, Asim. Then second question, I guess there are some media reports about a couple of refineries either in or near the Canadian border that might be up for sale. I think the Chevron Burnaby refinery is one that we know is. Can you—certainly you won't comment on those specific assets but maybe how you're thinking about your refining portfolio and what criteria would need to fit in order to be interested in such assets?

ASIM GHOSH:

Our strategy is to maintain reasonably tight integration between our Upstream and Downstream segments. It's a strategy that has stood us in good stead. It's clear that this business continues to show strong returns. All I would say is if you harken back to what Rob spoke a moment ago, we've started our pre-feed work on a potential 30,000 barrels a day expansion of our Lloyd asphalt plant which would provide an additional outlet for heavy oil thermal production without, dare I say, needing pipeline capacity to leave Canada. We'll have more to say after that work has been completed. Then, you know, we are continuing our organic improvements in terms of our existing facilities within Lima, within Toledo which Rob just spoke about, and anything else that we looked at, we look at inorganically will have to meet the return criteria of what we can achieve organically. It's the same as the M&A story and I think that basic discipline speaks to it all.

MIKE DUNN:

Okay. Thanks, Asim. That's all from me, and congratulations on your retirement.

ASIM GHOSH:

Thank you. Thank you so much.

OPERATOR:

The next question is from Fernando Valle of Citi. Please go ahead.

FERNANDO VALLE:

Hi guys. Thanks for taking my question and congrats to Asim and Rob on the retirement and new position. My question is really how are you balanced in the idea of bringing back the dividend with the growth? Because you're talking about sanctioning three new projects but at this stage you're still—you haven't reinstated the dividend. How do you weigh that decision and continue to grow versus bringing back paybacks to shareholders? Then, as a follow up on you disclosed the RINs cost and there's been some talk from other analysts on growing the refining footprint. My question is are you doing anything to mitigate those RIN costs going forward? Is there opportunity to work with your partner on the marketing side for your product in the U.S. to lower that cost? I'll leave it there for now.

ASIM GHOSH:

Let me take the dividend question first and then I'll hand over to Rob for the RINs.

The dividend question, frankly, you know, I would say I don't want to pontificate on the global oil markets but we are seeing some early indications the global oil supply that might come into balance. Frankly, is the balance done? Is the excess inventory used up? We've been a bit cautious about it and I think it's important to maintain that caution. The most important thing for us, I'll tell you we have three priorities. I don't want to artificially set a prioritization between that. There are three—I call them all three Class A priorities: a strong balance sheet, well that's been achieved. Tick the box. Second is dividend. We understand the importance of that dividend, and the third is a continued future development path for the Company. That's all I can say is at all times Management recommends to the Board to keep in sight all three priorities and we will continue to do that.

Now, on the RINs part, I'll just say, look, there are things that are cyclical, there are things that are not. We are focused on the controllable variables. We've been at a high point in the cycle in the time I've been in the industry on RINs, but I'll just hand over to Rob in terms of what our view on that whole thing is.

ROBERT PEABODY:

Thanks, Asim. I would just say that as Jon mentioned first, our RINs cost expense in the last quarter was about \$34 million and if you're following the market of course we're back up to RIN prices approaching \$1 a RIN, so that's again reaching a high point over the variability. We'll be interested to see what the EPA does as they reset their guidance, or not I guess, at the end of November.

In terms of mitigation, we do work on mitigation. We have some of our own blending facilities in order to help offset the cost as well, but as you may know, even those that are blending are often ending up with having to eat a lot of that cost in order to move product. So, it's a helpful strategy but it doesn't make the problem go away.

FERNANDO VALLE:

Fair enough. That's very helpful. Thank you guys and congrats again on the transition.

OPERATOR:

Thank you. 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 touch-tone phone to ask a question. If you wish to remove yourself from the question queue, press star, and two.

The next question is from Charles Varcoe—pardon me—Chris Varcoe of the Calgary Herald. Please go ahead.

CHRIS VARCOE:

Hi. Thanks for taking my call. A couple of questions. My first off is what is the Company's expectations of the impact of the federal or provincial carbon pricing on your operations, and particularly on your investment decisions?

ASIM GHOSH:

Let me take that, Chris, okay? We've always considered investment decisions based on what I'd call the precautionary principle approach, that Husky must be positioned for any policy changes that address climate change. Okay? We believe in a balanced approach that addresses the issue of climate change balanced with the economy and societal needs. Having

said that, basically in all of our planning and all of our investment, we take any reasonable costs that could be coming into the horizon into account before we sanction any project.

CHRIS VARCOE:

Okay. Just to follow up, you'd obviously made the big announcement regarding your retirement. Was there any specific timeframes driving that? I guess, why did you make that decision now?

ASIM GHOSH:

From a professional point of view, we reached a critical mass this year in terms of the six-year transformation. I have said we've been looking at a seven-year transformation at Husky, okay? Got the balance sheet under control, more than 40% of our production base now comes from low sustaining capital projects; that was a target we set out at the beginning of the year and we've now achieved that ahead of schedule, and we have significantly reduced our cost base, and yet there seems to be enough for Rob to do going ahead so it's not as if I've taken all the opportunities away from him. It's a terrific time, from my point of view, to hand over the baton.

I've never really brought my personal stuff into this but I have to tell you I had a granddaughter in April, another granddaughter arriving next week so there's a bit of a critical mass of pressure from the family coming up just about this time as well, but that's not what's driving me. What's driving me is the fact that we've reached that critical mass professionally of the Company and yet there is enough runway ahead for a new CEO. It's a good transition point.

CHRIS VARCOE:

Thank you.

OPERATOR:

Ladies and gentlemen, this concludes the time allocated for questions on today's call. I'd like to hand the call back over to Asim Ghosh for closing remarks.

ASIM GHOSH:

Thank you so much. Thank you for joining us and I have to say on a personal note that my time at Husky has been enormously professionally satisfying and I leave with a wrench in my gut but the heavy lifting of the restructuring is behind us. We have built a solid platform for growth and we will update you further on our plans in the guidance call in December, but it will not be me

doing that, it'll be Rob doing that. I'm delighted that we hand over, that I hand over the baton in a seamless manner. I thank you all for your support for the time I have been here. I will be continuing on the Board, by the way, so this is sort of au revoir rather than good-bye.

OPERATOR:

Ladies and gentlemen, this concludes today's conference call. You may now disconnect your lines. Thank you for participating and have a pleasant day.