Husky Energy

HUSKY ENERGY FOURTH QUARTER AND YEAR END 2012 CONFERENCE CALL & WEBCAST TRANSCRIPT

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Speakers:

Asim Ghosh
President & Chief Executive Officer

Alister Cowan
Chief Financial Officer

Robert Peabody
Chief Operating Officer

Sharon Murphy
Senior Vice President Corporate Affairs

OPERATOR:
At this time, I would like to turn the conference over to Sharon Murphy, Senior Vice President, Corporate Affairs. Please go ahead.

SHARON MURPHY:
Good morning and thanks for joining us for our 2012 Fourth Quarter and Year End results. With me are Chief Executive Officer Asim Ghosh; Chief Operating Officer Rob Peabody; our Chief Financial Officer, Alister Cowan; and Head of Downstream Bob Baird. This morning we`ll provide an update on our business strategy and an overview of results followed by a question-and-answer session.

Before we begin, I need to advise you that today's comments contain forward-looking information. Actual results may differ materially from expected results because of various risk factors and assumptions that are described in our quarterly release and in our Annual filings, which are available on SEDAR, EDGAR, and on our website. I`llnow turn the call over to Asim.

ASIM GHOSH:
Thank you, Sharon, and good morning. Before I get into the fourth quarter highlights, a snapshot on where we stand today in terms of the roadmap for balanced growth that I laid out for the first time in late 2010.

Overall, we are on course to meet the goals we defined through a series of specific financial and operating metrics. We`ve had a series of quarters of consistent execution and solid performance in an environment where the industry continues to go through a period of depressed Western Canada pricing. And basically that`s because our focused integration strategy is providing us with some safe harbor. And later in the call, Alister and Rob will provide more commentary around the specifics in the quarter.

However, let me start with a few highlights. Our net earnings from operations for the year of about $2 billion, a tad over actually, were comparable to 2011 when you exclude the after-tax gains that occurred from on the sale of non-core assets in the early part of 2011. And also I remind you that this reflects the impacts from, both the Atlantic Region FPSO off-stations and weak gas prices. Cash flow from operations of about $5 billion was also comparable to the previous year.

Reliable performance and strong throughputs in our Downstream business made a significant contribution to our earnings by capturing additional margins, which allowed us to achieve Brent-like pricing for all of our liquids production in what has been an ongoing climate of wide differentials, you know, Canada to U.S. differentials, Brent to WTI differentials and so forth.

Overall, if you look at our Downstream business, that contributed about $895 million to net earnings for the year compared to $813 million in 2011. And production was within guidance for the third consecutive year, averaging about 302,000 per day. I`ll move into operational highlights by key areas.

So, I`ll start with the foundation. Our Heavy Oil business has been rejuvenated over the past couple of years. This includes the earlier than anticipated start up and subsequent performance of our new Pikes Peak South and Paradise Hill projects. These exceeded the peak design rates and reached total average production of 17,000 barrels a day in the fourth quarter. We sanctioned our thermal development at Rush Lake. Our current production there is about 1,000 barrels per day from one pilot well only. We plan to expand this to a full 10,000 barrel a day commercial project, which will come onstream in the 2015 timeframe, and we continued construction at our thermal project at Sandall where we started to drill and expect first production next year.

So, suffice to say our thermal, heavy oil thermal production I would call it a strong story for us in 2012 and, in fact, we are set to build on that success over the long term.

In Western Canada, we continue to make headway with the transformation of our business with resource plays, where you will recollect, we have got a large land position of almost 2 million acres to develop our most promising prospects, and Rob will speak more to that in a moment.

I'll move on to the growth pillars. Start with the Asia-Pacific region, where we are hitting our milestones, according to plan. The Liwan Gas Project is on track, nearing completion as we move closer to realizing first production. The jacket is anchored on the floor of the South China Sea and we plan to move out the top sides to sit atop the jacket sometime in the second quarter.

Indonesia is turning into the next chapter of our growth in this region. We are developing three fields in the Madura Strait. You will recall at the Investor Day we told you that we`ve had four new gas discoveries in evaluation for commercial production in addition to what we already had in the past. So, if I look at Asia overall in summary, we remain on track to deliver production from Liwan in late 2013, early 2014 and that is kind of the next clearly visible operational output milestone that we`ll be looking for.

A quick update on Sunrise; the first phase is proceeding as planned towards production by mid-2014. All 49 of the well pads are drilled. The biggest component of this project, the central processing facility, is somewhere near the midpoint of completion while the field facilities are more than three-quarters done. And perhaps most importantly, I will remind you of that we`ve logged on more than 85% of the costs. That was quite a significant achievement as now the vast majority of the cost for Sunrise are under that umbrella of cost certainty.

In the Atlantic Region, we`re setting the stage for future development as they execute several key initiatives. The SeaRose FPSO came back on the line in the third quarter three weeks ahead of schedule and $8 million under budget after it`s off-station in Belfast, and production since then has been ticking along as expected. The extensional performance from the FPSO to date has provided a solid platform, we believe, for future development from the White Rose region. In fact, tomorrow, we will have produced 200 million barrels from the White Rose area and, through existing and new developments, we expect to recover as much again in the future.

We`re now focused on extending the life of this basin through near-field satellite projects for the South White Rose and West White Rose. We have started development drilling at South White Rose and pending appropriate approvals we expect to begin production next year. We are also looking at production from West White Rose sometime in the 2016, 2017 timeframe. The Atlantic region is a solid, stable, high netback part of our portfolio and we are strategically developing this reservoir to give us many more years of production.

So, to sum up, we are tracking well against our balance to the strategy. Our 2012 results demonstrate the strategies we have developed are delivering and I would say we`re building on our momentum as we prepare to execute the next phase of our growth plan. On that note, Alister, you want to take over?

ALISTER COWAN:
Thanks. Our fourth quarter results clearly support Asim's earlier comments; that we will be on course with our financial and operational targets throughout the year. And the focus on execution we formed over the past 2.5 years, has certainly given us a solid footing to develop major projects and most promising plays.

The net earnings in the quarter were $474 million or $0.48 diluted per share and that compares to $408 million or $0.42 per share a year earlier reflect stronger U.S defining margins due to favorable market prospects expressed, but I will remind you again that our product location and timing differences for our refinery output from the Chicago prospects which is commonly quoted. We also had stronger throughput of the Upgrader and is in the U.S refining and marketing business, but Oil Sands was offset by lower realized commodity prices in the Upstream business due to differentials.

This also takes into account the Searcher prospect in the Atlantic region. We drilled this well in the fourth quarter and didn't find any commercial hydrocarbons. So, we`ve expensed the $79 million drill cost in Q4. Our cash flow from operations was about $1.4 billion or $1.43 per diluted share over the fourth quarter as compared to $1.2 billion or $1.24 a year ago.

Turning to production we have reached 319,000 barrels of oil equivalent per day in the fourth quarter. And that's up approximately 12% from 285,000 BOEs per day in the previous quarter, and is comparable to production in the same period in 2011. As we said before these numbers reflect the SeaRose FPSO maintenance program which wrapped up in August and returned to full production earlier than planned as well as the Terra Nova off-station. It also reflects a planned decrease in natural gas production in favor of increasing light, medium, and heavy oil production as we shift capital to higher netback opportunities.

Our new heavy oil thermal project also made strong contributions to production as Asim said by ramping up well past the design rates they had on schedule.

In the Downstream segment; the Downstream business has supported our Upstream operations with consistently strong throughputs of safe reliable performance. You can see there is a focused integration strategy delivering Brent-like pricing for Western Canada heavy bitumen and light production. And as you have seen from our results over the last few quarters, it has helped to mitigate our earnings and cash flow volatility from the fluctuating differentials.

The Upgrader contributed $68 million to net earnings in the fourth quarter and that compares to $49 million a year ago and is in part due to higher upgrading differentials in volumes. The U.S refining operations are at $88 million to net earnings compared to $80 million in the same period of last year. And that, as I said, reflects an increase in realized refining margins as a result of higher market crack spreads of throughputs from the Lima refinery, but also takes into account lower throughput at Toledo which has some turnaround activity in the quarter.

Meanwhile, the infrastructure and marketing operations are at $84 million to net earnings in the fourth quarter. And that is an increase of $40 million compared with the same period in 2011 and that is a key part of our integration strategy and reflects our ability to move our crude to market in the U.S to mitigate the Western Canada location differentials. And as you can see from the MD&A there was a FIFO after-tax loss of approximately $27 million in the quarter. And that brings us an annual FIFO after-tax loss to approximately $28 million. Looking at pricing, you will find the details in the MD&A on the website but I will list a few highlights for the quarter.

The average realized price for Upstream production as a whole was $57.77 per BOE in the fourth quarter compared to $68.35 last year. And that reflects the impact of the Atlantic Region off-stations in lower Western Canada commodity prices. Average realized crude oil pricing was $72.17 per barrel, down from $89.79 a year ago, but was a slight uptick from the third quarter. The average realized natural gas prices in the fourth quarter were $3.25 per mcf, compared to $3.53 in the same period of 2011. Now you have seen that widening, a significant widening of differentials over the last few months and our focused integration strategy has proved itself in mitigating this volatility over the year. Rob will speak a bit more to that in a moment.

But a few items to note going forward. We are planning a major turnaround to the asphalt refinery in Lloydminster beginning in April and that will result in a 25-day total shutdown in operations with an estimated impact to throughput of about 29,000 barrels per day over the turnaround period. We will also be running a 30-day maintenance program starting in mid-May, of the Prince George refinery, and the expected impact to throughput is approximately 11,000 barrels per day over the turnaround period.

In the Atlantic Region, the Terra Nova facility is still ramping up its production, but more slowly than anticipated and our share of productions for Terra Nova in January was about 2,000 barrels per day.

From a financing perspective, we exited the year with a robust balance sheet which was backed by the strong operational results across the business. We`ve reached all the performance metrics as planned. We will start out a $4.8 billion capital expenditure program for 2013 and about 50% of that will be directed as to the growth pillars. I will also remind you that we continue to invest in longer cycle projects to fund growth beyond 2017 which means we will continue to have significant amounts of capital and development as we go forward.

And finally, the Board of Directors has approved a quarterly dividend of $0.30 per share. And now I am going to turn you over to Rob who is going to give us an update on the operations.

ROB PEABODY:
Thanks. Asim and Alister have already stolen most of my points for 2012 so I will take a few minutes to provide a little more detail on some of the highlights for the last quarter.

I'll start with heavy oil; our performance in this area, particularly with thermal SAGD technology, continues to demonstrate the long-term potential of this business. Asim updated you on the thermal part of this business where we remain on target to reach our goal of 55,000 barrels per day by 2017.

I'll just add that, at the end of the fourth quarter, the Sandall thermal project was 40% complete. Additionally, production from our horizontal well program which targets previously untapped thinner reservoir zones has now reached 8,000 barrels per day and continues to grow; 45 horizontal wells were drilled in the fourth quarter. We also continue to high-grade our remaining CHOPS drilling locations. In 2013, we expect to drill about 200 wells compared to the 250 wells we drilled in 2012. Total production from our heavy oil business was up 12% year on year in 2012.

Looking at our Western Canada business unit, we have been making consistent progress as we continue to shift away from conventional drilling to oil and liquids-rich gas resource plays. With respect to our oil plays, for the near-term projects, we were primarily active on the Bakken, Viking, and Cardium plays. We drilled 25 horizontal wells here in the fourth quarter.

For the longer term, we are working on the emerging oil plays at the Rainbow Muskwa in northern Alberta and the CNOOC at Slater River in the Northwest Territories. At Slater River, we have recently received regulatory approval to build the all-season access road. This year we will conduct further evaluations on the two vertical wells we drilled last year. The results from this evaluation work will help us determine the way forward of this potentially very large but complex play. Overall, production from our oil resource plays increased to about 7,000 barrels per day at the end of the quarter.

Turning to our liquids-rich gas resource plays . . . at Ansell, we exited the quarter at about 12,000 barrels of oil equivalent barrels per day of production. Today, we are now around 14,000 barrels of oil equivalent per day. We also brought on the latest of our Ansell Wilrich wells with encouraging results. We started drilling our first four-well pad at Kaybob targeting the liquids-rich Duvernay and we also completed our third horizontal well in the play. We also completed the second of our two Montney horizontal wells. In total, production from our oil and liquids-rich gas plays was around 20,000 barrels per day at the end of the quarter.

Moving to the growth pillars, as reported, the Liwan Gas project in the South China Sea is now more than 80% complete as we approach first production later this year or early in 2014. The 30 ton Mono-Ethylene Glycol or MEG unit has been attached to the top sides which will be floated out onto the jacket during the second quarter. Pipeline from the deep water gas field through to the shallow water platform and onto the onshore gas plant is on schedule.

In Indonesia we are moving ahead with our gas projects is on the Madura Strait block. Following the positive results from our recent exploration program we are now looking at bringing more projects online. We recently received approval from the regulator to develop the combined MDA and MBH fields and expect to see first gas in the 2015 timeframe. On the BD field, we have an approved development plan and gas sales agreement in place and we are in the retendering process for a leased FPSO.

Oil Sands development continued to progress. As you heard earlier, the Sunrise Energy Project is advancing with increasing cost certainty, following the conversion of all significant contracts to lump sum. We are also moving ahead with preliminary engineering for the next phase of Sunrise.

Finally, we expect to put in an application for a Saleski pilot later this year. In the Atlantic region, we are advancing our near-field developments at South White Rose and West White Rose. We brought a forced production well online at the North Amethyst drill center and our application to develop the deeper Hibernia level formation is now being reviewed by the regulator. Development drilling will start in the first quarter at the South White Rose extension and first oil is on schedule for 2014.

On the exploration front as Alister stated earlier, we finished drilling the Searcher prospect and didn't encounter commercial hydrocarbons.

Going forward, we are participating in the partner-operated Harpoon well which is near our previously announced Mizzen discovery. Pre-drilling work is also complete on two other potential exploration wells in the region that we are planning to drill later this year and possibly one of those may go move into the following year.

In the Downstream business, our focused integration strategy was the big story this year as we were faced with wide differentials and depressed Western Canadian pricing. As we told you at Investor Day there are three elements to our Downstream strategy. Increasing input flexibility to access a variety of crude options, increasing our product flexibility to improve the range of what we make and, finally, improving our market flexibility to get the best prices for our product. At both Lima and Toledo we are making modifications to allow for increased consumption of heavy feedstocks.

Some fourth quarter highlights from the Downstream, we are almost finished building our new kerosene hydro-treater at the Lima refinery. In fact I just heard we are starting commissioning on that. This will give us more jet and diesel production while preserving the flexibility to swing back into gasoline.

At the Toledo refinery which is operated by our partner, a new reformer unit has been installed. This reduces operating costs and increases our efficiency as well as our ability to make low vapor pressure gasoline.

In summary, we have had an active quarter and we continue to build momentum as we draw closer to production from our major projects at Liwan and Sunrise. I will now turn you over to the Operator.

OPERATOR:
The first question comes from Greg Pardy, of RBC Capital Markets. Please go ahead.

GREG PARDY:
Good morning. Really just wanted to dig in a little bit more into some of the projects that you`ve got on the horizon. So, can you talk a bit more about just Rainbow Muskwa what you`re doing up in the Northwest Territories?

And lastly, and I mean I know you did cover that off in your prepared statements, I'm just wondering if we could get a little bit more and what is your thinking then about the next phase of Sunrise in terms of the approach that you would be taking on that? Would you really use the same approach, or will you bring more of the control, etcetera in-house? Thanks very much.

ASIM GHOSH:
Let me try to – I`m going to hand you over a moment to Rob to talk about the resource plays, but I need to understand your question a bit more deeply on Sunrise. So, broadly our thinking is I mean we have got a SAGD project. It is sort of an off-location fabricated mod that gets shifted onto location and our broad thinking is to stick with that basic concept. What did you mean by controlled?

GREG PARDY:
No, that's okay. The question is really how much of -- whereas with the first project you have got Saipem thats overseeing it and running it as your general contractor and the question is is would Husky then look to become a general contractor with the subsequent phases, but I think you are probably answering it.

ASIM GHOSH:
Yes, no, I think not. I mean, I don't think we have – it`s not a core skill of ours and one of the things I have been concentrating on is we stick to what we do best. I don't think general contracting a project of that magnitude we would see as part of our core skill. So we would return to the project and we would tend to the project at the right time and that is how we would handle it. Rob, why don't you take the resource play questions?

ROB PEABODY:
I`m not going to give you much more information than you already have, and we discussed it at Investor Day. I mean, the one development in the near term is we did get approval for the all season access road which was a very positive development. And so, we have a program we are just testing. We are doing some further testing on the two wells we drilled last year and on the basis of that, we will determine the forward program both later in the year and next year.

So that`s where we are. As I have said time and again, we`re very encouraged that the hydrocarbons are there. But we also know this is a very complex environment in which to work.

ASIM GHOSH:
So, that`s it for the Canol and I think for the Rainbow Muskwa, I don't think we really have any more news than we shared with you in December. Implicit in that is there's no more good news and there's no more bad news. There literally is no more news.

GREG PARDY:
So let me ask it another way. When do you expect to talk more about this? Is it sort of at midyear, or?

ROB PEABODY:
Well, I think we will keep you abreast of developments as they happen. My sense of this, I know there's always this feeling that things are going to happen every month, but the fact is it takes a long time to get wells drilled and then to actually see production results. So, we --

ASIM GHOSH:
Yes, I think the general point we made, Greg, we pretty well have to read the wells for a year before we get a sense of the type curve. Because the shape of the individual well type curves varies so enormously that either we start premature conclusions that will be sort of resulting in either overhyping or under-hyping the true potential. And I think we are just being very, disciplined about it. So far, what we have seen gives us room for continued development, but not to draw firm conclusions and economics. That is just a very honest, straightforward answer in terms of we just have to be patient in developers to get a proper sense of the potential of these projects.

GREG PARDY:
No problem. That does answer it. Thanks very much.

OPERATOR:
The next question comes from Mike Dunn, First Energy. Please go ahead.

MIKE DUNN:
Good morning, everyone. Just a modeling question; guys, not sure if you have ever talked about operating cost expectations for Sunrise, I guess either Sunrise Phase 1 or sort of fully expanded to 200,000 barrels a day. But just any help on that front you can shed some light on. Thanks.

ROB PEABODY:
Yes, just a very short answer. I mean with gas price assumption of something like $5.00 to $6.00 sort of long-term gas price which is clearly way above what it is today, we would anticipate total operating costs in the sort of $17 a barrel range. So, as gas prices are lower than that, it would be a little bit less than that and if they are higher it will be a little higher than that.

ASIM GHOSH:
But the biggest single component of the operating cost is the gas price because the only component is the biggest single component.

MIKE DUNN:
Right and would that be sort of a Phase 1 indicative, guys or is that -- would it be higher in Phase 1 and then --

ROB PEABODY:
Yes. That's a Phase I indicative and you would expect to be able to pull them down a little bit as you expand the project beyond that although, clearly, gas prices are more linear. That being said, when we do Phase 2 the early engineering shows a number of projects to increase, the thermal efficiency of the whole project, that should help us on gas price -- or gas costs as well.

MIKE DUNN:
Thank you very much.

OPERATOR:
The next question comes from Paul Cheng, Barclays. Please go ahead.

PAUL CHENG:
Good morning. Several quick questions hopefully. Rob, when you are looking at your increasing heavy oil production later on the bitumen on Sunrise, have you looked at train as an alternative option to get the oil out? Is that a potential strategy for the Company or that you really don't believe that that is a viable solution for you?

ASIM GHOSH:
Let me take that question at the high-level first. I will remind you that Husky actually has a lot of pipeline connectivity in place and as a combination of our internal pipeline connectivities in Canada, our Hardisty terminal to which somewhere between 20%, 25% of all Canadian oil process are enoute to the U.S and a pattern train to the U.S, we are somewhat differently positioned from some of our peers.

So, our primary connectivity solution is focused around pipelines. And we have got a material amount of our production already covered through existing pipeline connectivities, connectors and we have got a plan to increase that. So, in our case we see rail as a bit of a stopgap solution into fill in the blanks where you have got blanks. So, it is a solution around the edges. And we are looking at expanding our rail capabilities, but even after we have done that it will be a relatively small part of our total picture. So, the thing with rail basically is, it is more flexible, but it is materially more expensive. So, if you have got the pipeline connectivity, pipeline is always the preferred to go, preferred way to go and --

PAUL CHENG:
I think your pipeline connectivity -- does it just go to the Midwest U.S or you go all the way down to the Gulf Coast?

ASIM GHOSH:
Present pipeline connectivities go to the U.S Midwest. We`ve got options on upcoming pipes to the Gulf Coast.

PAUL CHENG:
And that is essentially based on Keystone XL, right?

ROB PEABODY:
Based on Keystone predominantly.

PAUL CHENG:
Right. So I guess that that's the --

ROB PEABODY:
Enbridge, there are others.

ASIM GHOSH:
So, Paul, I think the important thing to understand, okay, I don't think these connectivities still (inaudible) but we actually have a pretty significant network of pipeline access. It is not based on one massive -- you know, winner take all type of solution.

We actually have a number of pipeline options and one of the reasons there have been a lot of pipeline constraints over the last and there have been [a portion] mix and the reason we have been able to write that out is actually we have got more than one solution. We have also got tankage at both ends of the dumbbell, so to speak. We have got tankage in Patoka we have got tankage in Hardisty, which allows us to mitigate the results of short-term dislocations.

So, you`re asking me about -- I would spend half the day explaining this and we basically have said, look, the simple answer is we have got a complex network of commitments in place and more coming up. But don't think of it as single dependency on if XL happens, or XL doesn't happen what happens to us. That's not the place we are in right now.

OPERATOR:
This concludes the analyst Q&A portion of today's call. We will now take questions from members of the media. There are no further questions at this time. I will hand the call back over to Asim Ghosh for any closing remarks.

ASIM GHOSH:
Well, thank you all for joining us. You know, I think I said this in the last Investor Day. I forget when I said it but it sounded pretty clever. So I will repeat it again. So, I mean just, basically, we strategized for three days in the year and we executed for 362. That is my mantra to the guys, to my colleagues inside the Company. And that is what we are trying to drive.

There is no major change in our strategy since we first started running 2.5 years ago and since that time as you can see from the results we achieved this quarter and throughout 2012, it is in the process of delivering results for us and consistent execution is, again, our mantra for 2013. So thank you for joining us today and look forward to a conference call a quarter from now.

OPERATOR:
Ladies and gentlemen, the conference is now concluded and you may disconnect your telephone. Thank you for joining and have a pleasant day. Goodbye.