Husky Energy

HUSKY ENERGY FIRST QUARTER 2013 CONFERENCE CALL & WEBCAST TRANSCRIPT

Date: Tuesday, May 07, 2013

Time: 8:00 AM MT

Speakers:

Asim Ghosh
President & Chief Executive Officer

Alister Cowan
Chief Financial Officer

Robert Peabody
Chief Operating Officer

Rob McInnis
Manager, Investor Relations

OPERATOR:
At this time, I'd like to turn the conference over to Rob McInnis, Manager, Investor Relations. Please go ahead, sir.

ROB MCINNIS:
Good morning, everyone. Thank you for joining us for our First Quarter results. I'm here with CEO, Asim Ghosh; COO, Rob Peabody; CFO, Alister Cowan; and Bob Baird, who runs our Downstream operations. We're going to provide an update on our business strategy and an overview of our first quarter results. This will be followed by a question-and-answer session.

Later this morning, we will hold our Annual Meeting of Shareholders in Calgary. A webcast of the meeting will be accessible on our website at huskyenergy.com. That presentation begins at 10:30 a.m. Mountain Standard Time.

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 our website. I'll now turn the call over to Asim.

ASIM GHOSH:
Thanks, Rob, and good morning, everybody. It's been another quarter of consistent execution across all our business segments. Our net earnings were $535 million, which is up 13% over the last quarter despite the very significant price depression we've been seeing for heavy crude in Western Canada. We'll amplify a little bit later, but that speaks to the strength of our focused integration strategy.

Our production continues on pace, 321,000 barrels a day, which was up a tick from last quarter and within our annual guidance, and importantly, it's also weighted 72% towards oil and liquids compared to 69% a year ago, Implicit in that is the fact that oil production was up 4.5% year-over-year. There has been some tightening in terms of pricing discounts but our integrated business model continues to provide a Safe Harbour. In effect, we are capturing world pricing for our Western Canada oil production and, again, Alister and Rob will provide more context on this but I wanted to start off with a little bit of high level detail on the key elements of our business, and I'll start with what I've, in the past, called a foundation.

Heavy oil continues to be a pack leader for our production in Western Canada. We had two new thermal projects at Pikes Peak South and Paradise Hill which started last year; continue to perform well over the quarter and they are paving the way for our next suite of thermal projects. The next ones coming up will be Sandall and Rush Lake. In Western Canada, we are ramping up activity across our oil and liquids-rich resource plays to set the stage for future production and basically transition this basin -- that part of our business. So as we move forward, we are proving up our assumptions around the potential of our resource play portfolio and while it's early days, it'd be fair to say we've some encouraging signs.

On one of our emerging plays, which is the Canol in the Northwest Territories, we completed two vertical wells drilled last winter and we've started community consultations for the next stages of high activity. And finally, it's one of the proverbial least but not last, in terms of our foundation, Downstream operations continue to demonstrate consistent reliability and we saw strong throughputs again this quarter.

As far as the growth pillars are concerned, in the Asia Pacific region, the Liwan Gas Project gets into the home stretch this year. Our next big milestone is just around the corner. The top sides are making their way across the South China Sea from the northern end of China to the southern end of China to be connected with the central platform jacket within the next couple of weeks, and I remind you, this is about 30,000 tons; 41 metres high. This is the largest offshore platform ever built in the Asia Pacific region. You may recollect, I think in one of our past meetings, I spoke about the jacket which had been already installed on the seabed and that I basically likened that to the Calgary Tower at about 200 metres high, so if we continue that analogy, if you placed the Palliser Hotel on top of the Calgary Tower, that's about the physical size of what the finished structure will look like, and that platform is going to gather our Liwan gas from deep water wells and send it 260 kilometres to an onshore gas plant, and again, sticking with Alberta size and distance analogies, that's about the distance from Calgary to Edmonton, and from there, it gets processed and sold to the mainland China market.

In Indonesia, we are moving forward in two gas developments in the Madura Strait. That have been approved by the regulator and also evaluating the commercial potential of four new gas discoveries that we announced last year.

At Sunrise, we are moving ahead as planned to deliver first oil in 2014 and, overall, the project's about two thirds complete and while our sights, at this point, are clearly focused on making sure that Phase I gets going, we have recently filed a regulatory application for a bitumen carbonate pilot at Saleski, and you'll recollect that about a year ago, I think we've given some indications of the size of this resource.

In the Atlantic region, we continue to have a strong track record of execution on the White Rose and moving to develop -- to further develop our long-term growth potential here. We had a historic milestone this year. We reached 200 million barrels earlier this year of total cumulative production from White Rose and when we went into this project, that was our total production target over the full project life from White Rose. So we've already done that, and at this stage, we have some confidence that we can do close to as much again over the next many, many years of production. So compared to ingoing targets, this is going to be a very, very attractive project for us. We are also continuing to look beyond the White Rose in terms of exploration prospects. The partner-operated Harpoon well in the Flemish Pass was spread in early April. Drilling is continuing. We don't have results on that yet, but this is one of several wells in our planned exploration program over the next couple of years in the North Atlantic.

In summary, it would be fair to say we are executing our plan. We are delivering results as expected and advancing our major projects towards first production. The next two big ones are sort of late 2013, early 2014 and mid-2014.

Alister, do you want to take over from there?

ALISTER COWAN:
Thanks, Asim. It's been a good quarter on the financial front, reflecting the benefits of the focused integration strategy. Just let me briefly touch on a few highlights.

As Asim mentioned already, our net earnings of $535 million demonstrated a very strong performance considering WTI and Brent crude oil prices were lower versus Q1 2012. The higher Western Canada and heavy oil differentials continue to be mitigated by our focused integration strategy. Our results also reflect an increasing oil weighting, with strong production from our heavy oil projects, stronger Downstream throughputs which allowed us to capture higher refining and upgrading margins. Our cash flow from operations is up about 8% at $1.3 billion dollars or $1.30 per diluted per share; that compares to $1.2 billion or $1.20 per diluted share a year ago.

Our first quarter production came in as expected, with approximately 320,000 barrels of oil equivalent per day compared to 319,000 BOEs in the previous quarter, and a slight increase over Q1 2012 production. As Asim mentioned, these volumes are increasingly oil and liquids weighted as a result of our ongoing planned decreases in natural gas production in favour of higher netback oil and liquids-rich plays.

In the Atlantic region, the partner-operated turnover facility has brought its third drill centre back into operation following this off-station program last year. However, some remaining operational issues are still being worked out.

Our Downstream business reflected our focused integration strategy and the business continued to show strong performance over the quarter. The Upgrader contributed $132 million to net earnings in the first quarter compared to $48 million a year ago and that reflects the wider heavy oil differentials.

U.S. refining and marketing operations added $145 million to net earnings. That's up more than 104% compared to $71 million in the first quarter of 2012 and this primarily reflects higher throughputs of the Lima refinery, as well as favourable market crack spreads and the lower-price feedstock we have been able to obtain. As you will have seen in the MD&A, there was a FIFO after-tax gain of approximately $10 million in the quarter.

In regards to pricing, the MD&A, of course, provides all the details but here is a few points. The average realized price for Upstream production as a whole was $54.43 per BOE in the first quarter; that was down nearly 20% from $65.26 in Q1 2012. The average realized price for crude oil and natural gas liquids and bitumen was $68.32 per barrel; that's down more than 27% from a year ago, and that reflects the lower WTI and Brent pricing quarter-over-quarter but also takes into account, the continuing wide product and location differientials we've been seeing in Western Canada.

I'll just remind you at this point that the costs of the Western Canada location differentials for Upstream production shows up in the Infrastructure and Marketing business unit in Upstream, where net earnings in the quarter increased to $134 million from $56 million in the first quarter of 2012. And then, of course, we further captured margins from the increased differentials in the Downstream business of the Upgrader and the refinery. Average realized natural gas prices were slightly higher, at $3.08 per Mcf compared to $2.64 a year ago.

Now as you know, Q2 is typically the start of the turnaround season and we do have a few scheduled outages on the calendar. We've just wrapped up a 25-day turnaround at the asphalt refinery in Lloydminster and the estimated impact to throughput was about 29,000 barrels per day over the turnaround period. We also have a 30-day turnaround starting later this month at the Prince George refinery and the estimated impact to throughput will be about 11,000 barrels per day during the turnaround period. And while it's still a couple of quarters away, we'll be having a major turnaround of the Lloydminster Upgrader in September and the facility will be offline for about 45 days then.

Finally, the Board of Directors has approved a quarterly dividend of $0.30 per share. I'm going to hand you over to Rob to give you an update on the operations.

ROB PEABODY:
Thanks, Alister. We continue to improve our process and occupational safety performance. We've seen steady progress with lowering our total recordable injury rate, which in 2012 was the lowest I can remember. With respect to process safety, with the implementation of the HOIMS Management System, our incident rate

has fallen about 60% since the start of 2010. As expected, this has also translated into higher reliability, demonstrating again that good safety is good business.

I'll start the business review in heavy oil. Asim already touched on the performance at Pikes Peak South and Paradise Hill. You'll recall these projects, which are the vanguard of our accelerated thermal development program, came on stream ahead of schedule and ramped up past their design rates within two months of first production. Our next two thermal projects are proceeding as planned. At Sandall, which is a 3,500 barrel per day project, construction is about 55% complete and initial drilling is underway with production anticipated in 2014. At the 10,000 barrel a day Rush Lake commercial thermal project, it's also advancing and based on results from our first well pilot pair, we're planning to start up a second pilot later this year.

Also in heavy oil, we've had an active quarter on the drilling front, with 38 horizontal heavy oil wells drilled out of a planned 140-well program for the year. We also drilled 55 CHOPS wells, and we're looking at another 145 wells over the balance of the year.

Turning to Western Canada, as we move forward in rejuvenating this business, we are accelerating our activities around oil and liquids-rich plays and as Asim mentioned, we're seeing some great results. Looking first at our oil resource plays, we drilled a total of 45 horizontal wells in the quarter across our Bakken, Lower Shaunavon, Viking, Cardium and Rainbow Muskwa oil resource plays. We also completed two vertical wells that were drilled last year in the Canol play in the Northwest Territories, which, as we've said before, is a project for the long term. In the same play, we've completed about half a 40-kilometre all-season access road and construction is set to resume on this road in the third quarter and we're also in the process of consulting the community about our next steps for the program this coming winter.

Looking at our liquids-rich gas resource plays, the Ansell project is shaping up to be a real needle mover for us in Western Canada. We've brought our well cost down about 40% over the last year and production has also been on the rise. We are now producing about 14,500 barrels of oil equivalent per day and have recently shifted more of our budgeted capital to the area from other plays. Just to give you some perspective on the resource at Ansell, at the end of 2012, we had approximately 88 million barrels of oil equivalent proved reserves, 19 million barrels of probable and 398 million barrels of contingent resources booked for the Ansell area. Over the first quarter, we drilled four horizontal wells and six vertical appraisal wells on the play, as well as completing another 12 wells. At Ansell, we now have good producers in the Cardium, the Wilrich and the Falher reservoir horizons.

Moving to the liquids-rich Kaybob Duvernay play, we continued to drill our first four-well pad in the play following some good results from our first production well.

Looking at the growth pillars, you've already heard how the Liwan Gas project in the South China Sea is being readied for first production. The operation to winch the 34,000 ton top sides on to the offshore barge was completed as planned. It really was a marvelous feat of precision to see this massive structure move so smoothly onto the vessel. Soon, as Asim mentioned, we're going to install the top sides on the jacket. This will be done by floating over the top sides and then lowering it onto the jacket. It's my understanding that this will the largest floatover ever done in our industry.

In Indonesia, development plans for our two shallow water gas fields in the Madura Straits continue to progress. Just a reminder, we have a gas sales agreement in place and we're still evaluating the tender bids for the floating production, storage and offloading vessel that we plan to use to develop the BD field.

In oil sands, the first phase of the Sunrise Energy project is coming together and is on track for first production next year. All the well pads and pipelines are close to completion and are scheduled to be finished this year. We are also wrapping up preliminary engineering work on the next phase and expect to start FEED in the next quarter, and we have filed a regulatory application for the Saleski pilot project in the Grosmont carbonate formation west of Fort McMurray. This pilot project calls for cyclic horizontal steam injection technology to recover the resource from the carbonate rocks. You may recall an independent evaluation in 2011 raised the total best estimate contingent resource holdings in our oil sands portfolio to about 11.4 billion barrels and the majority of these additions, or about 10 billion barrels, were attributed to the Saleski lease, which Husky owns 100%.

In the Atlantic region, work on our near-field developments at North Amethyst, South White Rose and West White Rose continued to progress. We drilled a fourth water injection well at North Amethyst over the quarter and we're looking for it to start operations in the third quarter. Development drilling continues on the first gas injection well at the South White Rose project, which is going to be tied back to the SeaRose FPSO, and we completed front-end engineering for the West White Rose project in the first quarter and we're now preparing the development application.

In the Downstream business, as Alister mentioned, the focused integration of our business continues to pay dividends for us in the quarter by helping us to capture world oil prices for our Western Canada production. The strategic investments we've been making at Lima and Toledo are giving us increased flexibility to source the best crude oil imports, to make the right products and to access the best markets at the right times. The kerosene hydrotreater at the Lima refinery started up in April and we expect it to increase our distillate capacity, as well as giving us additional capacity to swing between jet and on-road diesel production. It also allows us to modestly increase our intake of Canadian crude while still maintaining product quality.

The reformer unit at our partner-operated refinery in Toledo is now up and running, giving us the opportunity to reduce operating costs while increasing efficiency.

So overall, we've been executing as planned across our foundation businesses and making steady progress on our growth pillars as we approach some important milestones later this year and into 2014.

Now, turn you back over to the Operator.

OPERATOR:
Thank you. Ladies and gentlemen, we will now begin the analyst question-and-answer session. Any analysts who wish to ask a question may press star, and one, on their touchtone telephone. You will hear a tone acknowledging your request. Please ensure you lift the handset if you are using a speaker phone before pressing any keys. If you with to remove yourself from the question queue, you may press star, and two. Any analyst who has a question may press star, and one, at this time. There will be a brief pause while we compile the Q&A roster.

The first question today comes from George Toriola of UBS. Please go ahead.

GEORGE TORIOLA:
Thanks and good morning, guys. My -- I have a couple of questions. The first is on Liwan and Sunrise; what -- this is for Asim; what do you see as the key remaining risks on both of those projects?

ASIM GHOSH:

I think basically it's -- I think the most important thing -- let me tell you the biggest potential risks in these projects is the resource and the -- that risk is fortunately behind us in both the projects. So, we've now completed and tested the wells in Liwan. They work, and it's a source of some relief to us and satisfaction to us that that big risk is behind us.

Likewise on Sunrise, we've got the -- we've completed the wells. We know the resource is of the caliber we expected at that because the wells are in the right place, and that risk is behind us. So these are two massive risks that are behind us that we are very relieved about.

Going forward, frankly, the things we have now got are executional risks, so this is a big floatover. Rob just told you this is one of the biggest floatovers ever -- actually, the biggest floatover that we are aware of, certainly the biggest floatover ever done in Asia. Just the execution of that, the hooking up of the top sides to the jacket, these are just -- no, I can't point out to any single element of it as being a massive risk. So, we are down to a series of elements in the chain, each of which has to be executed for the whole chain to link up.

Likewise on Sunrise, the project is two thirds complete, pretty well three of the legs are done, which is the wells, the pads, the field facilities; they are well under control. The field facilities and the pipelines are well under control. We are now focusing on the core of the -- the central processing plant, which is a complex -- it's a big part of the project, and that's just a question of executing step-by-step-by-step. You know, the bulk of the modules are already on site but now we start the construction of the modules on the site, hooking it all together, and I don't want to belittle the complexity of that task in what is a difficult basin to work in, you know, with its labour productivity issues, weather issues, all of that.

So -- but fundamentally, I can't point to any single thing that is kind of -- it's a massive execution task, that's all. Yes.

GEORGE TORIOLA:
Okay, that's helpful. And so I assume that cost inflation is not one of the key risks you see for any of those projects from here on?

ASIM GHOSH:
Well, it's not an easy basin to work in, but so far, we have no reason to see a blowout of any kind, okay? I mean, we have done the bulk of the conversion. As I said, three of the legs are kind of under control, so we watch this on a day-to-day basis. I don't want to give you a sense that we are in a complacent mood. It really takes a lot of managing.

GEORGE TORIOLA:
Okay, that's helpful. The other question – probably this is for Rob – is your Saleski project. What is that based on? That pilot, is there a certain technology or what are you -- what is that pilot going to be based on?

ASIM GHOSH:
Do you feel that I am sufficiently out of control of the technology of the question that he shouldn't pass the question to me?

GEORGE TORIOLA:
Oh, no, no, no, Asim. No, no. Certainly not; I just thought maybe it's more in (cross talking).

ROB PEABODY:

George, you may have gotten me in a bit of trouble there, but I'll answer the question anyway. I mean essentially, we're looking at using cyclic horizontal steam injection. We've done a lot of technical background work. We believe that's probably going to be the best prospective technology. Of course, it's a pilot for a reason, but that's the technology we're looking to.

GEORGE TORIOLA:
So, essentially, huff and puff is what you're talking about here.

ROB PEABODY:
Yes, with a horizontal well.

GEORGE TORIOLA:
Okay, okay. Okay, and what's the basis for the 3,000? Why not 5,000, 10,000, 1,000, whatever? Why is it 3,000?

ROB PEABODY:
It's just optimizing the kind of -- it's absolutely just optimizing the information we get back for the money we're spending.

GEORGE TORIOLA:
Okay, and so when do you expect that you would have approvals and when would you be in the field here?

ROB PEABODY:
Well, we've just put in the application so it could easily be something in the order of 12 months, but we're basically targeting towards something in the 2,000 and…

ASIM GHOSH:
Fourteen.

ROB PEABODY:
Fourteen period; 2015 I would say actually, that construction could start and then, ultimately, about three years after that probably be into production.

GEORGE TORIOLA:
Okay, great. Thank you very much, guys.

OPERATOR:
The next question is from Paul Cheng of Barclays. Please go ahead.

PAUL CHENG:
Hey, good morning, guys. A number of quick questions. Alister, on Liwan, when they come on stream there, the cash flow should be pretty strong. Any rough estimate that what may be the cash flow look like for 2014 from that project?

ASIM GHOSH:
Alister, why don't you take that?

ALISTER COWAN:

Well, I think we've given guidance about the production which will ramp up to about, our share of 150 million cubic feet a day, and there, our gas price is between $11 and $13 per Mcf and then we have indicated to, like to everybody that there's about $700 million of exploration expense which we will get back over the first sort of 15 months. Most of that will come in the first 12 months.

PAUL CHENG:
And Alister, that on the $700 million that -- do you get 700, or do you get the 51% of not (inaudible 26:48) not supposed to? So, if that 700 is net that you will be achieving, or it is the gross that you're talking about?

ALISTER COWAN:
No, no, we get the whole thing back.

PAUL CHENG:
So 700?

ALISTER COWAN:
Yes

PAUL CHENG:
Okay. On Sunrise then, can you share with us that what may be the expected cash operating cost and the sustaining capital once that you start up?

ROB PEABODY:
Yes, the cash operating cost on Sunrise is in the order of -- it depends on the gas price, of course, but somewhere in the order of about $16 a barrel and of that, it's roughly kind of dollar-for-dollar with gas price, so if -- that's assuming about a $6 gas price, so if you get a few dollars less than that, that'll reduce our cash operating cost.

PAUL CHENG:
Rob, how about the sustaining capital requirement going forward on that project?

ROB PEABODY:
Yes, there is a -- you know, in the project over its lifetime, there's about -- about two thirds of the capital is actually in sustaining capital over its lifetime. I don't have that figure right with me for dollars per year but we can get you that.

PAUL CHENG:
That would be great. And maybe this is for either Rob or Asim. With the natural gas price showing some sign of life, from a portfolio standpoint that -- are you saying that now that you have just too much opportunity in the heavy oil and the oil side, so you're not really going to be interested in putting any money in natural gas, or that under what market conditions that you will reconsider that maybe perhaps that going back and spending more money there?

ASIM GHOSH:
So, I want to make a couple of points there. First of all, we have not been spending any money in dry gas for the last couple of years and which is why we actually -- one of the reasons we've been able to maintain Western Canada despite increases in things like Ansell is because our dry gas is coming down. But having said that, we are spending money, as we speak, on liquids-rich gas and that speaks to the fact that Ansell,

which was running about 4,000 barrels a day a year ago is now running at 14,500 barrels a day. It's because of major investments we've been making in that area.

The second point is, I think at the level at which the prices are today or any of the steps we are seeing for the next couple of years, going out in the next couple of years, we still wouldn't, at those levels, be spending money on dry gas.

The final point, I think I should remind you of is that we are also a substantial consumer of gas with our thermal plays. That is increasing in heavy oil, and as our Sunrise project comes on stream and ramps up, it will increase even more. So at the end of the day, we are kind of neutral to it. We have an internal hedge and on our present plans by 2020, we will pretty well consume four out of every five million cubic feet that we produce. So, in a sense, we are kind of neutral to the outcome of this whole exercise to where the gas price is because we're getting ourselves into a position of a substantial internal hedge.

PAUL CHENG:
Thank you. A final one; Alister, that for Indonesia, the two shallow gas developments, you say you have the gas contract on hand. What's the volume and the price from those contracts and the duration?

ALISTER COWAN:
I don't think we're able to say what those are yet, Paul. I mean, they -- we have an agreement but we're still finalizing all the details around that.

PAUL CHENG:
All right. Thank you.

ALISTER COWAN:
But the gas price, current gas prices in Indonesia are between $6 and $7.

PAUL CHENG:
Okay, very good. Thank you.

OPERATOR:
The next question is from Greg Pardy of RBC Capital Markets. Please go ahead.

GREG PARDY:
Hi, good morning. It was a very thorough rundown so I didn't have a lot of questions, but I'm just curious as to what the program might look like in the Northwest Territories for the winter of next year, just specifically, on the Canol shales?

ASIM GHOSH:
Rob, why don't you…?

ROB PEABODY:
Sure. As I said, we're -- the first thing we've got to do is just get in there and finish our all-weather road off. We are -- we're always a little hesitant and we'd like to talk to the communities before we talk too much about our plans, because clearly, they will be formed by the agreements we have with the local community, and we're also still analyzing the results from our two evaluation wells. But certainly, with the encouragement we got from that, we are looking to move forward with, as I say, completing the road, probably drilling a couple of

more vertical wells and then following on with probably two horizontal wells, just subject to the final results of the vertical wells later in the year.

We're also going to expand our seismic program up there. You know, we did a very large three -- or a large 3D seismic program, but again, we wanted to -- based on some of the results we've seen, we've actually decided we're going to expand that seismic program a little further than when we're -- where its original sort of footprint.

GREG PARDY:
Okay. Thanks, Rob. Is there any -- go ahead.

ROB PEABODY:
(Inaudible 32:07) consultation with communities.

GREG PARDY:
Is there anything you can say just around, you know, just what the vertical test yielded, either in terms of gravity of crude or what the distribution might have been in the production profile of gas? Are you seeing any -- is there any condensate? Is it strictly light oil?

ROB PEABODY:
I don't think we've released any of those results to date and Sharon's telling me that if I do, I'll get in trouble.

GREG PARDY:
Okay, well -- so, I don't want that to happen. Thanks a lot.

ASIM GHOSH:
It's -- we've got a large land position, okay, so even within our land position, I think we will straddle a few windows, well -- you know, even after the level of confirmation, I think it'll be -- I doubt even after that, after our complete exploration program is complete over the next couple of years, I doubt we'll give you a simple conclusion as to it is this or it is that; there'll be a range of products, assuming that we do find them in commercial quantities; commercial exploitable quantities.

GREG PARDY:
Okay. All right, thanks very much.

OPERATOR:
The next question comes from Andrew Potter of CIBC. Please go ahead.

ANDREW POTTER:
Hi, guys. First question is just on the Muskwa; maybe if you can comment at all on initial well results, what you've seen or just the general tone around the play and if you can just remind me how many wells you actually have on stream right now in that play?

ROB PEABODY:
Okay. I'll see if -- maybe my colleagues beside me here might be able to come up with the number of wells we have on stream. We have a number of wells in the play. In the Muskwa, similar to several resource plays, there is, you know, we're looking at a play that has an oil window, likely a liquids-rich gas window and ultimately even a dry gas window. So, we have wells in -- across a variety of areas there and we have

producers in the oil window and in the liquids-rich gas window. And what -- the task we are kind of undertaking right now is optimizing two things. One is optimizing production rates on the wells, which is really about optimizing the well completions designs, and then the second thing we're working is driving the cost down of our wells there in order to drive it into a good economic position, and we've had some great drilling results of late. We've actually, I think just lately, we drilled a well for something approaching, you know, 27% of the -- 27% cost reduction of our junior wells, so we -- I think the latest one came in for about $5 million.

So we're on track, we think, in terms of getting the cost down, the production up, but we're not yet at the position where we want to be for the whole play, and very similar to Ansell, it's going -- I think it's going to take us a couple of years to get it to the place where we're really happy with it, to really push our -- put on the accelerator.

ANDREW POTTER:
Sure. And then just moving to the oil sands, one question on Sunrise. I mean, we've seen a few of your competitors kind of moving away from doing the big scale SAGD plans and kind of, you know, electing to go to smaller phase growth kind of spread over a longer period of time. How are you thinking about Sunrise II and III? Is it still -- should we still be thinking in the 60,000 barrel a day plus kind of range, or are you rethinking the options there as well?

ROB PEABODY:
Yes, so what I'd say there is, first of all, just being mindful, we're actually -- in our heavy oil thermal plants, we've probably gone to a smaller scale than many of the other operators and certainly in that environment, we've seen some great benefits. The other thing to understand is, in Sunrise, even though -- so if we look at Sunrise Phase I, we talk about that as being a 60,000 barrel a day phase, but it's really two phases of 30,000 barrels a day, and so really, our module size that we're building up there is 30,000 barrels a day and we phased those slightly in order to actually keep our total work force at the site at lower levels, which is -- which helps with capital efficiency. And as we think about Phase II, we'll be using the same philosophy there, so even though -- and I don't think we've said exactly how we're doing the phases, but as we expand to 200,000 barrels a day on the Sunrise lease gross, it will be through a series of modules that will really be developments of this 30,000 barrel a day module. It might be slightly bigger as we've optimized the facilities, but they're really a series of those modules.

ANDREW POTTER:
Right. And with -- so when will see some more definition, I guess, on the Sunrise II?

ROB PEABODY:
Well, we -- we're just going into the FEED phase of it, so the definition should come out of that. To be frank – and Asim's sitting next to me – we -- you know, we're very focused on delivering Sunrise Phase I before we advertise too much about Sunrise Phase II, and so even when I mention Sunrise Phase II to Asim, he normally says something about first finish Sunrise Phase I, so…

ANDREW POTTER:
Okay. And then the very last question just on the Duvernay, maybe you can just comment on your overall level of interest in the play and I guess -- I mean, you don't have a lot of -- a ton of running room right now. I think it was 35,000 acres. I mean, there's a lot of Duvernay lands on the market right now. Is that something that you guys would look at getting bigger in that play, or are you content with your…

ASIM GHOSH:

I will -- I'll let Rob answer that in a minute, but I just want to say one thing about resource plays, which is I think there's too much focus -- I mean, I hearken to my old experience in telecom when at one stage, the internet all about eye balls, and I think, likewise, the equivalent of that is there's too much focus on resource plays on acreage. I think what we've been focusing on Husky is dense acreage, okay, and so the reason I make that point is we do believe that our land position in the Duvernay is in a dense part of the acreage and it is something we have to educate ourselves more about, not to be seduced by overall acreage numbers. We have been focusing in all our resources plays on the qualitative factors as opposed to just the sheer quantity.

Okay, on that general note, can -- Rob, why don't you just tell us more about our Duvernay position.

ROB PEABODY:
Yes, so as you said, you know, our acreage position in the Duvernay is probably in the mid-20s in terms of thousands of acres, but we do believe we're kind of right in the heart of the play. We've had excellent well results on the wells we've drilled. I don't think we've released individual well results. In our policy of wanting to get kind of enough wells before, you know, where we think there's some -- a good statistical reason or statistical basis for the data, but everything we've drilled in our area so far has been -- had very high liquid yields and so the wells looked very good. And we've also been able to bring costs way down on the Duvernay as well, and I think the latest well we really think we've drilled the pace setter well in the whole region for costs from what we can see, and we think that's going to be advantageous.

As you point out, there's a reasonable amount of acreage on the market. Some of that's in the dry gas window; some is in the oil window, which may or may not work very well, and then the liquids-rich part of the play that probably, I suspect, has some of the best returns, and we're in a good position. We've actually continually expanded our acreage in increments and one of the reasons I think we'll be -- continue to be able to do that is because of our operational performance, which makes us a very attractive operator for other partners to use and the fact that there's an awful lot of wells that have to be drilled there fairly soon, in order too for other companies to maintain their acreage positions.

So we feel pretty good where we are, and as I say -- as Asim said, because of the resource density in our acreage, while it's not an Ansell play with, you know, hundreds of -- hundreds and hundreds of millions of barrels of resource to exploit, this is still not an immaterial amount of resource, even on our acreage position.

ANDREW POTTER:
Sure. And some of the wells we've seen recently have had liquids yield in the 200 to 300 barrels a day -- or barrels per million. Are you guys up in that neighbourhood, or can you comment at all on the liquids yield?

ASIM GHOSH:
Well, I mean…

ROB PEABODY:
Yes, in the neighbourhood (cross talking).

ASIM GHOSH:
I mean, I can't give you guidance, but we can certainly say that those numbers don't sound absurd to us.

ANDREW POTTER:
Perfect. Thank you.

OPERATOR:
Your next question is from Brian Dutton of Credit Suisse. Please go ahead.

BRIAN DUTTON:
Yes, good morning. I was wondering if you could please give us some more insight into your infrastructure and marketing business unit? There were big earnings this quarter but, historically, those earnings have been very volatile, so I was wondering, how do you look at the core earnings of that business unit?

ASIM GHOSH:
Okay, so I think the most important point, as an overall point, and then I'll hand you over to Alister, but the most important point to remember here is that those earnings have been volatile because benchmark prices have been volatile, and so we see that part of the business as a mitigating factor to the volatility, and if you really are looking to the qualitative robustness of that, it's not like pure trading earnings in a pure trading organization where you're taking market positions and the mark -- and your trading goal may work out or not work out. We are not trading -- making trading calls; we are simply selling what we produce. Okay?

On that note, Alister, let me sort of let you amplify on the specific results.

ALISTER COWAN:
Yes, so, Brian, as Asim said, the infrastructure and marketing arm, a lot -- most of the earnings from there come from moving oil from Western Canada down our committed pipeline capacity down to the U.S., so as differentials move around, you either see the earnings -- if they're wider, as they were in this quarter, you'll see the earnings in the I&M section because we pay -- our Upstream business gets the Western Canada price but the Company realizes a U.S. price and the difference is reflected in I&M. If the differentials narrow, the profit moves to the Upstream business unit and the I&M section business unit will show lower earnings, but on a combined basis, they're pretty stable.

BRIAN DUTTON:
Right, could you back out then or perhaps give us then what's the infrastructure component of the earnings then?

ALISTER COWAN:
Well, it's all essentially infrastructure.

BRIAN DUTTON:
Right, because I'm trying to back out then the swing which migrates between infrastructure and marketing and the Upstream side of the business, so what's the remaining earnings of that business that does not migrate between the Upstream and the infrastructure business unit?

ALISTER COWAN:
Well, I think if you go -- in our MD&A, there's a section on the infrastructure and marketing and essentially, there is, if I just look at that – I'm just getting that in -- there's an infrastructure gross margin; that's the bit that doesn't move. That's just standard tolling we do on the pipelines we have in Western Canada. The marketing and other gross margin is essentially the bit that moves between Upstream and the I&M segment, depending on location differentials.

BRIAN DUTTON:
Okay, thanks a lot. Thank you very much.

OPERATOR:
The next question comes from Phil Skolnick of Canaccord Genuity. Please go ahead.

PHIL SKOLNICK:
Yes, thanks. A couple of questions. Number one, at Liwan, is there any other kind of spending or drilling that you can do to expand that capital recovery beyond the $700 million? And number two, given the large amount of cash flow that's coming from Liwan, what's the plans to utilize that cash for? Thanks.

ASIM GHOSH:
Sorry, do you want to take the cash flow part? So, I will address what -- the plans to utilize the cash, but you just...

ALISTER COWAN:
Yes.

ASIM GHOSH:
But you just answer the first part of it.

ALISTER COWAN:
No, the exploration drilling is essentially done on Liwan and that's what the $700 million relates to. We're in development phase, so everything we -- obviously, we recover the development cost. The exploration was incurred by us solely as part of the typical PAC you get in China and the quid pro quo is you get the $700 million back.

ASIM GHOSH:
Okay, so I think on the plans to utilize the cash flow, I think we've given you overall guidance on the five-year plan on our -- on both our cash flow, as well as our CapEx program, and very simply, I mean, the plan is to utilize the cash flow for the CapEx program in the short term. But more importantly, if I were to take a strategic view, I mean let's just look back to five years and we had the repositioning of Western Canada as an initiation, we had the exploration (ph 45:30) thermal in the heavy oil, we had the low-hanging upgrading of our Downstream assets and then we had two mega projects. So that takes us through to 2015, and in that timeframe then we've also said that we are now looking to set -- create optionality for the longer term. So, we are just, at this stage, not giving guidance on what specific next stage of development will be the Atlantic region, et cetera, but we are creating the optionality on every part of our business. In heavy oil, that consists of acceleration; in the Atlantic region, it consists of the West White Rose development, which we have given you some guidance -- not some -- conceptual thinking about, and looking further out, the exploration prospects, and then the resource plays we've spoken about in Western Canada, and we just -- at this point, we're just creating optionality but we are making progress in definition of the potential in each of those areas year-to-year.

PHIL SKOLNICK:
Okay, thanks.

ROB PEABODY:
I'd just add maybe that we have a very strong pipeline of long-term development projects.

PHIL SKOLNICK:

Okay, great. Thank you.

OPERATOR:
As a reminder, analysts who wish to ask a question may press star, and one, on their touchtone phone. The next question comes from Mike Dunn of First Energy. Please go ahead.

MIKE DUNN:
Yes, good morning, everyone. A couple of questions. I guess first on your Saskatchewan thermal heavy oil projects, can you just talk to the design steam oil ratios for some of these projects? I know your latest ones are producing well over design capacity. I'm assuming that's because the steam oil ratio is considerably lower than what the facility nameplate design was. And I've got a follow-up on Liwan after that.

ROB PEABODY:
Okay, Mike, just -- it's Rob. Just a quick one on that. We designed those projects initially around three as a steam oil ratio and as you quite rightly point out, we're operating probably around two; a little below two at the moment. That will change a little bit over the life of the projects as well, so we do anticipate some increase in that over the longer term on the project, but they are definitely coming in at a much better steam oil ratio than are originally designed for.

MIKE DUNN:
Great, and then the upcoming thermal projects as well would be designed around three?

ROB PEABODY:
Well, I actually think -- I think the upcoming ones are probably going to be -- I think the design's starting to incorporate a little bit of the learnings, but they're still designed for a number closer to three than, say, under two.

MIKE DUNN:
Right, okay. And -- thanks, Rob. And then switching to Liwan, or specifically I guess the Lihua; how should we be thinking about -- obviously, you haven't got a commercial gas sales agreements finalized there yet, but how should we be thinking about volumes from Lihua?

ASIM GHOSH:
Alister will take that.

ALISTER COWAN:
Yes, we're still in discussions on the gas price, so clearly, we won't be moving ahead on the development or completion of the Lihua project, which is really it's actually 29-1. Until that's done, but we're looking probably in the late 2015 timeline before you see the volumes coming out of there and that'll be what takes us up from about 150 million cubic feet a day of gas to 300 million cubic feet a day of gas.

MIKE DUNN:
Great, that's all for me. Thank you.

OPERATOR:
This concludes the analyst question-and-answer portion of today's call. We will now take questions from members of the media. As a reminder, please press star, and one, on your touchtone phone to ask a question.

If you wish to remove yourself from the question queue, press star, and two. The first question comes from Jeff Lee of Pipeline News. Please go ahead.

JEFF LEE:
Yes, this question's for Rob. Rob, what's the impact of the spring breakup on your operations in Western Canada this year?

ROB PEABODY:
Well, it's been an interesting spring breakup in that, so you'll note, that we had some pretty big blizzards and everything, but overall, we don't anticipate -- it doesn't affect our guidance or anything. We're pretty comfortable with that. We always plan a little bit of down -- it's not -- a little bit of reduction. We've actually gotten much, much better in handling some of the weather conditions that are thrown at us at this time of the year in Western Canada, probably a lot to do with some modern technology we're able to employ in some of our operations that allow us to repair better and then recover faster. So overall, a little bit of an effect this month but -- and last month, but nothing that's outside our guidance range.

JEFF LEE:
Okay. Thanks.

OPERATOR:
As a reminder, any media who wish to ask a question may press star, and one, on their touchtone phone. The next question comes from Rebecca Penty of Bloomberg News. Please go ahead.

REBECCA PENTY:
Hi there. I just had a follow-up question about the dry gas prices and when Husky would invest in dry gas, and I'm wondering what price does Husky need to see in order to boost production of dry gas?

ROB PEABODY:
I guess I'd just say, Rebecca, that the -- you know, it varies from play-to-play, clearly, even in dry gas, depending on drilling cost and that, but I think -- I wouldn't depart a lot from what I would call conventional industry wisdom that at -- with current costs and everything, and the big question is when do you redeploy capital from something that's quite profitable into dry gas, which at the moment isn't. So, I think the hurdle to move in -- the money in that direction is a little higher maybe than it would be to have withdrawn the money, so I still think it's going to take -- people are going to need to see $5 or $6 probably in -- with the current cost base out there to really get excited about putting any more money into that, and even then, it'll depend a little bit on their alternatives.

ASIM GHOSH:
Okay, I just want to note that even in the U.S. resource plays, we are seeing rig counts that, even as we speak in the recent recovery, rig counts had been coming down.

REBECCA PENTY:
Right.

ASIM GHOSH:
And that's in a basin where, in every other basins, they've got a hell of a lot more experience and had a hell of a lot more time for optimization, and so clearly; clearly the industry is self-correcting.

REBECCA PENTY:
Just to clarify, when you're talking about $5 or $6 gas, are you talking U.S. dollar, NYMEX, or are you talking Canadian (cross talking 52:43).

ROB PEABODY:
I'd probably say I'm not being that precise, but pick your benchmark.

REBECCA PENTY:
Okay. Thank you.

OPERATOR:
There are no further questions. I will hand the call back to Mr. Asim Ghosh for any closing remarks.

ASIM GHOSH:
Well, thank you all for joining us and thank you for your questions. Like to remind you we'll be holding our AGM in Calgary later this morning, which will be webcast. At the meeting, I'll basically reiterate the following: First of all, that our strategy is standing the test of time. As a company, we are proving our ability to execute and deliver on our plan with some measure of predictability and consistency and most importantly, I think, in this year, we are now getting to the position where, if you go back to three years, I spoke to -- spoke of a balanced growth strategy, and today, the growth part of that balanced growth strategy is now getting to be in our sights.

On those high level notes, thank you again for joining us and I look forward to some of you, at least, being on the webcast. Bye.

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