Husky Energy – Buy: 13.59

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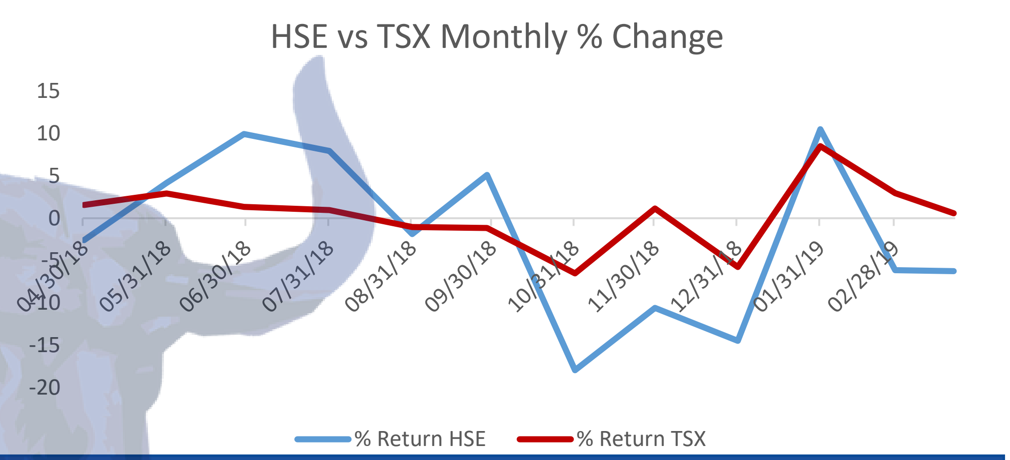
Company Overview

Company Highlights

- Husky Energy is an integrated energy company operating in Canada, the United States, Norway, Indonesia, China and Norway. It operates both an upstream and a downstream segment and is headquartered in Calgary, Alberta
- Operates 5 refineries and 557 retail outlets worldwide
- Currently pumps roughly 304,000 equivalent barrels of oil per day

52 Week Stock Performance



Key Individuals

Robert J. Peabody, CEO

- Prior to being appointed as Husky CEO in 2006, Mr. Peabody served as VP-growth strategy for BP and supervised record growth

Robert W. Symonds, COO

- Mr. Symonds was appointed COO in 2017. Prior to this he served 6 years as Husky's SVP for Western Canadian Production.

Victor Li, Majority Shareholder

- Through his holding company – CK Hutchinson Holdings, Mr. Li controls more than 70% of Husky shares

Growth Oriented Strategy

- Husky has embarked on an ambitious growth strategy with acquisitions in the South China Sea and the Madura Strait
- By 2023, Husky plans to grow its daily pumping capacity by 36%, raising barrels per day production to approximately 413,000
- Aside from boosting revenue, expanding operations internationally provides a hedge against localized production quotas as well as an opportunity to exploit different grades of oil and natural gas.

Sources: FactSet, Bloomberg

Core Business

Product Mix - Oil

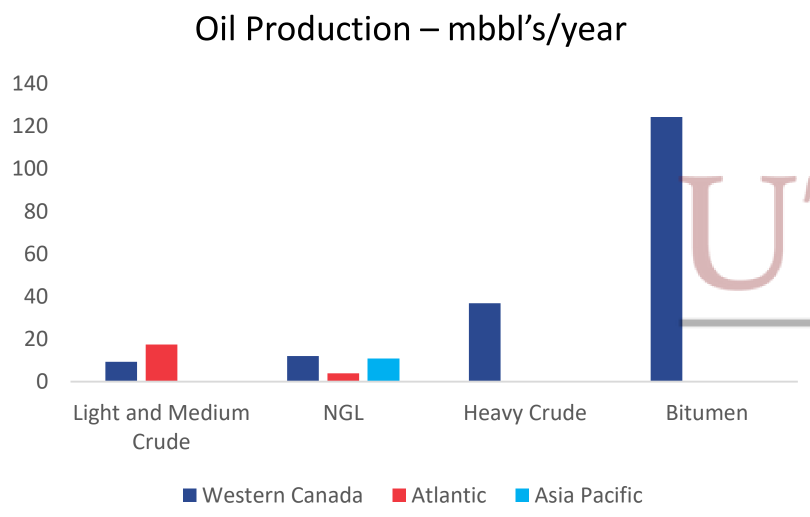
- Most of Husky's oil extraction occurs in the rich Athabascan basin though a fair proportion of lighter products are extracted in the Maritimes
- Crude oil and derivative production fell by 8% in 2018. This is mainly due to the suspension of operations on the SeaRose vessel along with higher than expected water cuts
- Given the higher price of crude, the bulk of Husky revenue comes from this segment.

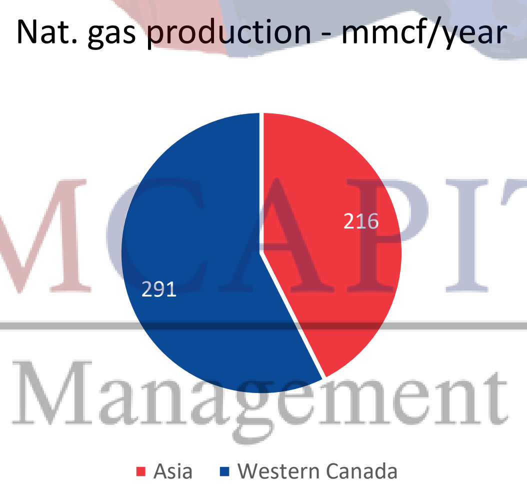
Product Mix – Natural Gas

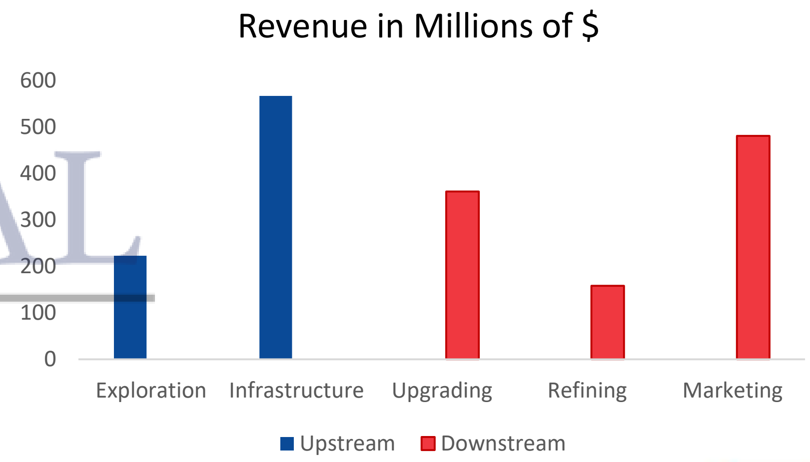
- Natural gas production by contrast is more evenly distributed between Western Canada and Asia
- The lower cost of natural gas (6.64 per mcf vs. 42.16 average per barrel) is offset by the higher volume of natural gas being pumped.

Upstream vs. Downstream

- Husky's upstream segment includes exploration, production as well as infrastructure development
- The downstream segment primarily generates revenue through direct sales to customers but also through upgrading and refining







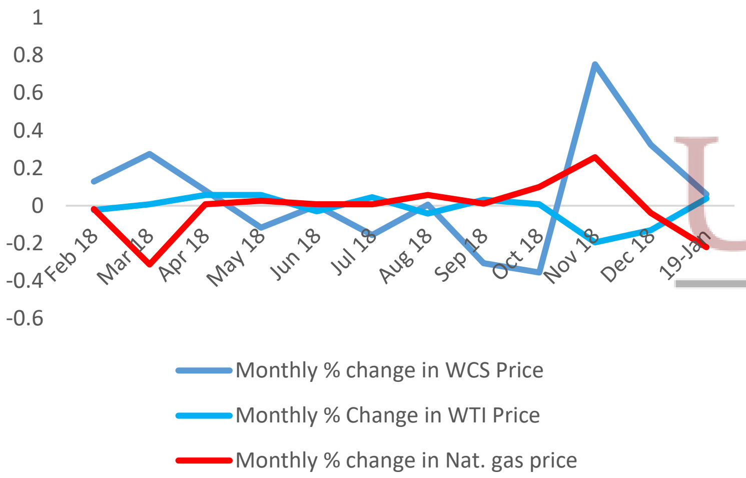
Sources: FactSet, Husky 10k

Macroeconomic Trends

Oil Prices

- Oil prices have been extremely volatile in the previous year given geopolitical and economic tensions
- WCS in particular has jumped wildly. Production quotas in Alberta have caused the price to jump 75% by the end of 2018 though the price is once again beginning to fall.

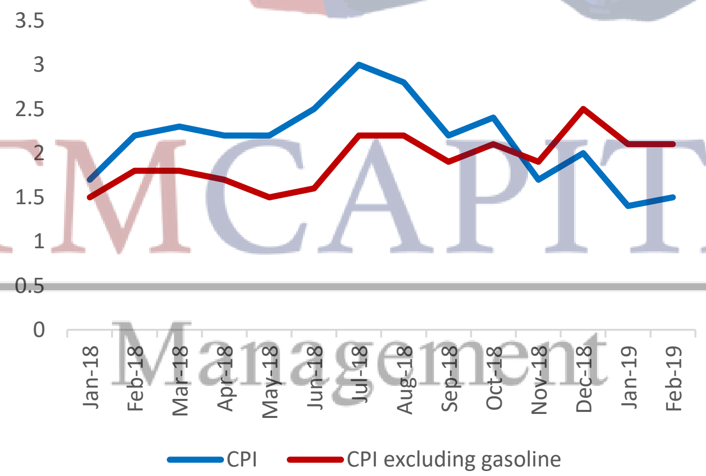
Oil Price Fluctuations in 2018-2019



Inflation

- Inflation shows a strong positive correlation with rising oil prices
- The recent trend in rising oil prices cause caused a spike in the CPI. This may factor into CB decisions to raise rates in the near future.

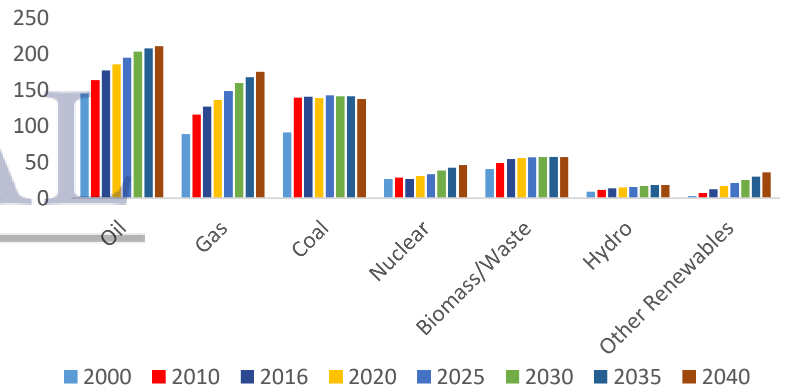
CPI 2018-2019



Energy Demand Growth

- Energy demand is forecasted to increase significantly in the coming decades
- Oil, natural gas and renewables are forecasted to be the primary sources of energy growth.
- The Asia-Pacific region (China and India specifically) will be primary demand drivers

Energy Demand Growth (in Millions of BTU's)



Sources: FactSet, Enbridge, OPEC

Industry Outlook

Oil Production

- Bringing more wells online is expected to increase the total amount of oil pumped by Canadian producers alone by over 1 million bpd over the next 7 years
- Advancing technology is also accelerating the upgrading process in refineries

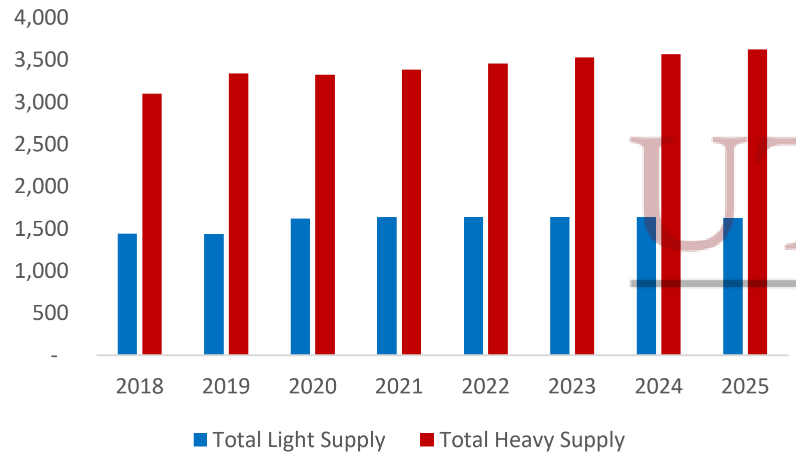
Supply Capacity

- Alberta plans to raise supply caps by allowing an additional 25,000 bpd per month to be pumped until July where it will be capped to 3.71 million bpd
- While supply quotas have nearly doubled the price of WCS, they have hamstrung larger firms such as Husky
- The industry as a whole has been increasing the amount of oil and NGL's pumped per day prior to the implementing of quotas

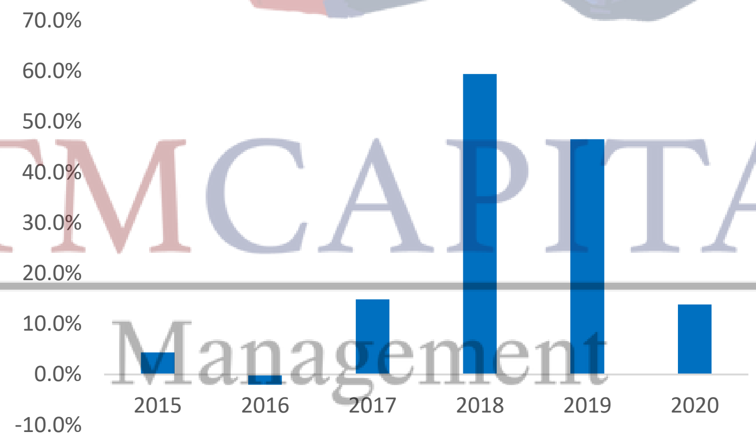
Proven Reserve Capacity

- Extraction techniques are gradually becoming more efficient which increases the lifespan of existing wells
- This is important due to the high costs of extraction and refinement of Canadian crude. Increasing productivity of relatively cheaper deposits is vital for growth in the industry

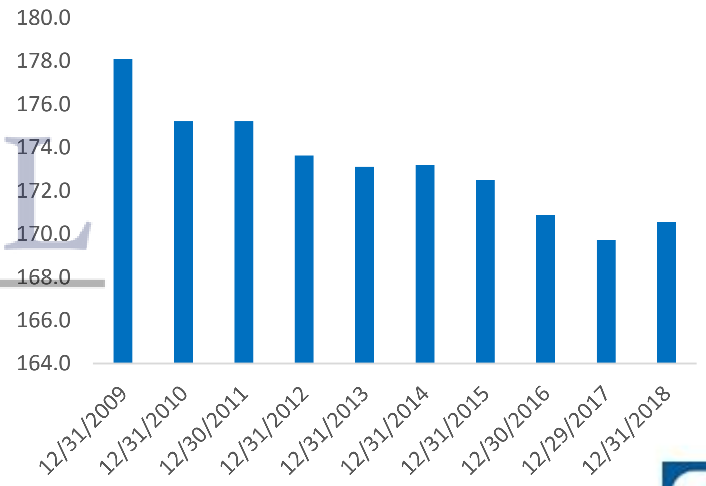
Oil Production in Millions of bpd



Production Per Day - Growth



Canadian Proven Reserves



Sources: CAPP, FactSet

Investment Thesis

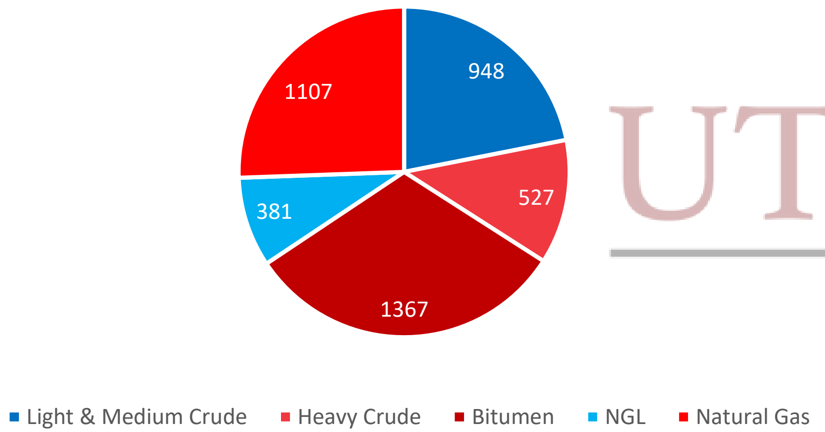
Husky's bid to become a fully integrated producer

- Husky's strategy going forward is to become fully integrated by 2022 at the latest.
- Leveraging growing Asian natural gas production will allow Husky to substantially lower costs at their heavy oil production sites and significantly increase profits.

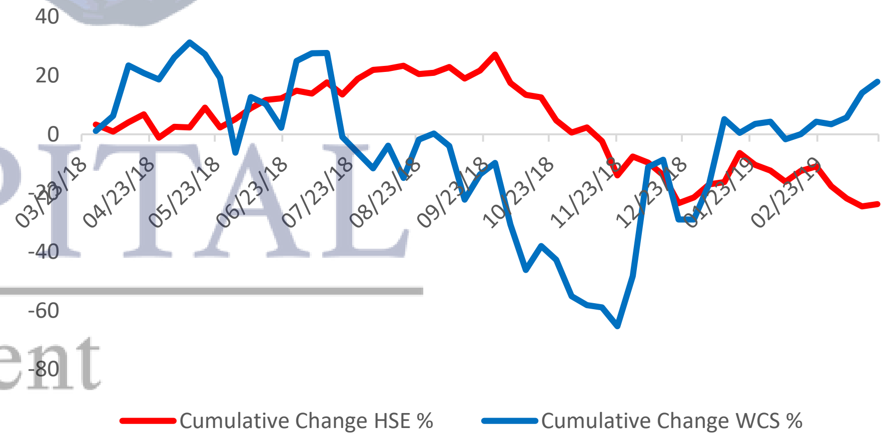
Widening differential between WCS price and Husky stock

- Historically, HSE's share price has followed the WCS spot price very closely (Immediately prior to the quotas, the two had an R^2 of .91).
- Since the implementation of production quotas, there has been a clear divergence between the two in price. This spread must eventually narrow given how HSE revenue is inherently dependent on the WCS price.

Revenue from resource extraction



Return % differential between HSE and WCS



Sources: FactSet, Husky 10k

Valuation I: Comparable Companies

Husky Energy	Fiscal Period	Market Value	Price to Earnings			EV/EBITDA			EV/Sales			PEG Ratio
			LTM	2019E	2020E	LTM	2019E	2020E	LTM	2019E	2020E	LTM
Imperial Oil	12/31/2018	$ 28,327.10	12.07x	14.80x	13.10x	6.52x	7.80x	7.90x	0.94x	1.00x	1.00x	0.50x
Suncor Energy	12/31/2018	$ 71,395.40	18.79x	17.80x	14.50x	6.13x	6.80x	6.40x	1.97x	2.30x	2.10x	1.80x
Candian Natural	2018-09-30	$ 44,418.40	15.49x	18.80x	14.70x	5.84x	7.00x	6.30x	2.83x	3.50x	3.20x	5.00x
Cenovus Energy	12/31/2018	$ 14,462.90	0.00x	22.20x	17.40x	23.14x	6.60x	6.20x	1.27x	1.30x	1.20x	0.90x
Average		$ 39,650.95	11.59x	18.40x	14.93x	10.41x	7.05x	6.70x	1.75x	2.03x	1.88x	2.05x
Median		$ 36,372.75	13.78x	18.30x	14.60x	6.33x	6.90x	6.35x	1.62x	1.80x	1.65x	
Husky Energy	10/28/2018	$ 13,660.00	9.97x	18.30x	13.10x	4.67	4.6	3.9	0.83x	0.90x	0.80x	5.40x
Premium (Discount) to Median												
Oil and Oil Refiners			-28%	0%	-10%	-26%	-33%	-39%	-49%	-50%	-52%	300%

EV/EBITDA Multiple	Bear	Base	Bull
2019E EBITDA (In Millions CAD)	4481	4481	4481
Multiple	4.40x	4.60x	4.80x
Implied Enterprise Value	$ 19,716.40	$ 20,612.60	$ 21,508.80
Equity Value/Share	$ 16.97	$ 17.86	$ 18.75
Discount Rate	8.43%	8.43%	8.43%
Implied Share Price	$ 15.65	$ 16.47	$ 17.29
Implied 1 Year Return	15.15%	21.20%	27.25%

Commentary:

- Husky is very attractive compared to its peers based on all metrics.
- EV/EBITDA being lower than Husky's peer group in particular suggests an attractive opportunity to purchase a company trading at a discount relative to competitors

Valuation II: DCF

(Millions of Dollars)		Historical					Projected						
Calculation of FCFF	Units	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Operating Scenario	1 Base												
Revenue		$24,092	$16,369	$12,919	$18,583	$22,252	$21,050	$22,145	$24,027	$26,430	$29,470	$33,301	$38,129
% Growth		*97.5%*	*-32.1%*	*-21.1%*	*43.8%*	*19.7%*	*-5.4%*	*5.2%*	*8.5%*	*10.0%*	*11.5%*	*13.0%*	*14.5%*
Cost of Goods Sold (Excl. D&A)		17,528.0	12,391.0	10,080.0	17,127.0	19,949.0	17,892.8	19,930.5	20,423.2	22,465.6	25,049.1	28,305.5	32,409.8
Gross Profit		6,564.0	3,978.0	2,839.0	1,456.0	2,303.0	3,157.6	2,214.5	3,604.1	3,964.5	4,420.4	4,995.1	5,719.4
% Margin		*27.2%*	*24.3%*	*22.0%*	*7.8%*	*10.3%*	*15.0%*	*10.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Selling, General & Administrative		462.0	342.0	544.0	650.0	654.0	617.0	649.1	704.2	774.6	863.7	976.0	1,117.5
EBITDA		6,102	3,636	2,295	806	1,649	2,541	1,565	2,900	3,190	3,557	4,019	4,602
% Margin		*25.3%*	*22.2%*	*17.8%*	*4.3%*	*7.4%*	*12.1%*	*7.1%*	*12.1%*	*12.1%*	*12.1%*	*12.1%*	*12.1%*
Depreciation & Amortization		0.0	0.0	0.0	2,882.0	2,591.0	3,157.6	2,657.4	2,402.7	2,114.4	1,768.2	1,332.0	762.6
EBIT		6,102	3,636	2,295	(2,076)	(942)	(617)	(1,092)	497	1,075	1,789	2,687	3,839
% Margin		*25.3%*	*22.2%*	*17.8%*	*-11.2%*	*-4.2%*	*-2.9%*	*-4.9%*	*2.1%*	*4.1%*	*6.1%*	*8.1%*	*10.1%*
Income Taxes		238.0	-87.6	1,797.0	-261.6	254.3	-163.5	-289.4	131.7	285.0	474.0	712.1	1,017.4
EBIAT		5,864	3,724	498	(1,814)	(1,196)	(453)	(803)	365	790	1,315	1,975	2,822
Free Cash Flow Adjustments:													
Plus: Depreciation & Amortization		0.0	0.0	0.0	2,882.0	2,591.0	3,157.6	2,657.4	2,402.7	2,114.4	1,768.2	1,332.0	762.6
Less: Capital Expenditures		0.0	(865.0)	66.0	48.0	2,342.0	2,216	2,109	2,048	1,989	1,923	1,840	1,725
Less: Increase in NWC							(550)	(425)	(457)	(562)	(707)	(549)	118
Free Cash Flow to Firm							-$61.7	-$679.2	$262.7	$353.8	$453.0	$917.7	$1,977.1
Weighted Average Cost of Capital		8.43%											
Discount Period							1.0	2.0	3.0	4.0	5.0	6.0	7.0
Discount Factor							0.92	0.85	0.78	0.72	0.67	0.62	0.57
Present Value of FCFFs							-$56.9	-$577.7	$206.1	$255.9	$302.2	$564.6	$1,121.8

Husky Energy
WACC Calculation

Cost of Debt	
Pre-Tax Cost of Debt	4.40%
Income Tax Rate	27.20%
After Tax Cost of Debt	**3.20%**
Cost of Common Equity	
Risk-Free Interest Rate	1.67%
Levered Beta	1.23
Market Risk Premium	7.63%
Cost of Common Equity	**11.05%**
Cost of Preferred Equity	
Preferred Dividend	$0.25
Share Price	$14
Cost of Preferred Equity	**1.84%**
WACC	**8.43%**

Exit Multiple Method	
Enterprise Value	$19,831.9
Less: Total Debt	$4,248.0
Less: Preferred Securities	$622.0
Less: Non-Controlling Interest	$0.0
Plus: Cash & Equivalents	$2,866.0
Implied Equity Value	$17,827.9
Shares Outstanding	1005.1
Implied Share Price	$17.74

Perpetuity Growth Method	
Enterprise Value	$21,282.3
Less: Total Debt	$4,248.0
Less: Preferred Securities	$622.0
Less: Non-Controlling Interest	$12.0
Plus: Cash & Equivalents	$2,866.0
Implied Equity Value	$19,266.3
Shares Outstanding	1005.1
Implied Share Price	$19.17

Risks

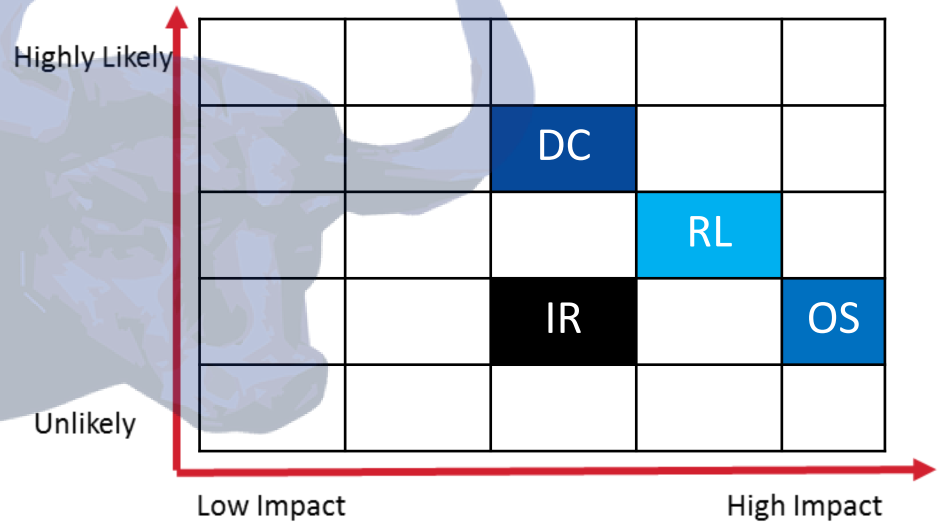
Oil Spill
Husky's operations, specifically its newer projects are vulnerable to accidental spillage. The explosions at the Superior refinery in 2018 as well as the SeaRose spill serve as a reminder of the environmental and financial impact accidents cause

Drastic Change in Oil Price
Due to the volatility of oil prices, Husky (and other producers) are at the mercy of market forces. This is particularly relevant for Canadian oil producers who are forced to sell at the WCS differential compared to WTI

Regulations and Laws
Changing regulations are unpredictable, though new environmental production laws passed domestically as well as the risk posed to Husky's foreign operations is noteworthy

Inherent Operational Risks
Some of Husky's operations are situated in dangerous environments subject to disasters such as forest fires and iceberg collisions. Proper procedures to manage these risks can help mitigate their impact however.

Scenario Analysis



(OS) Oil Spills and accidents

(DC) Drastic Change in Oil Price

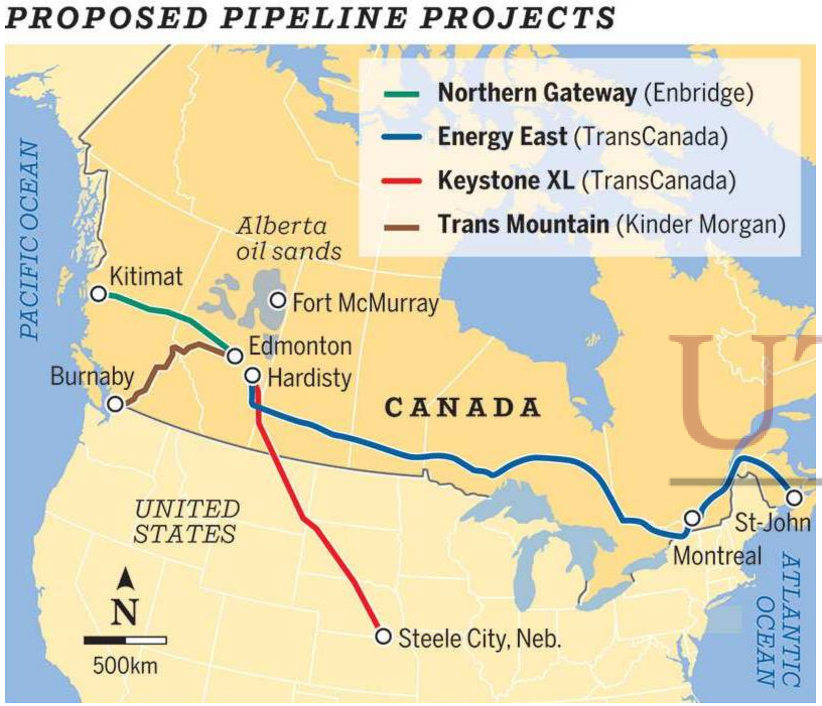
(RL) Regulations and Laws

(IR) Inherent Operational Risks

Catalysts

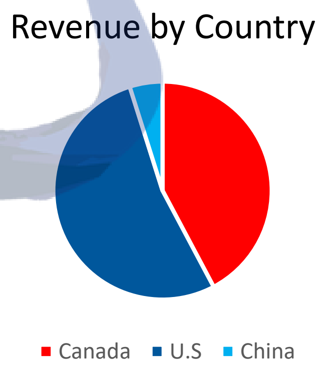
Pipeline and Transport Capacity Expansion

- Construction of the Keystone XL and Trans mountain pipelines will be a key catalyst for large Canadian oil producers and Husky in particular
- Currently, lack of access to shipping avenues is severely constraining the amount of oil Husky is able to move



Asian Expansion

- Expanding operations in Asia will help Husky extract different grades of oil to counteract the natural WCS/WTI spread

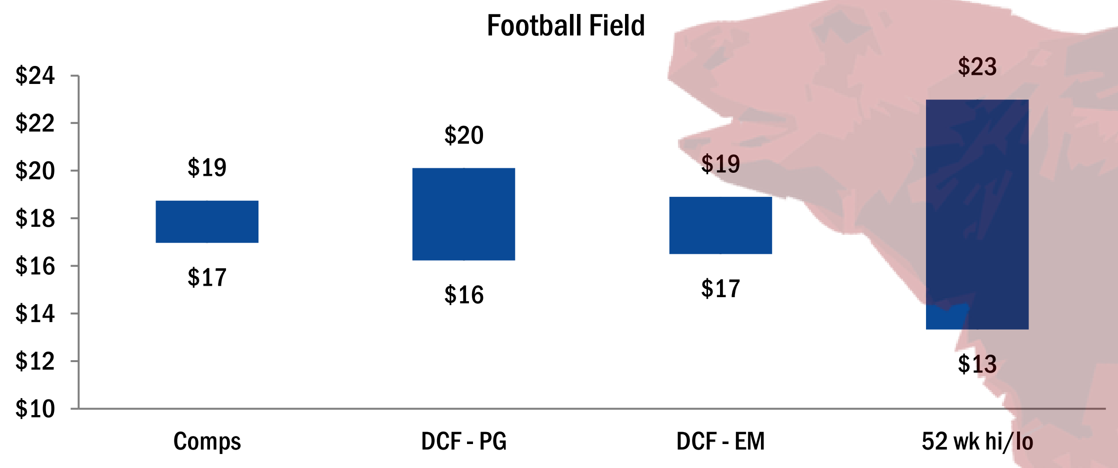


Expansion of the Integrated Corridor

- Increasing efficiency and connectivity between Husky's upstream and downstream segments will decrease the substantial costs associated with upgrading oil.

Recommendation

Valuation Summary



Sensitivity Analysis

Implied Share Price

Long Term FCF Growth Rate

$19.85	2.5%	2.6%	2.7%	2.8%	2.9%
10.3%	$12.26	$12.43	$12.60	$12.77	$12.95
9.3%	$15.19	$15.42	$15.66	$15.90	$16.15
8.3%	$19.17	$19.51	$19.86	$20.22	$20.60
7.3%	$24.88	$25.41	$25.96	$26.54	$27.14
6.3%	$33.68	$34.58	$35.53	$36.54	$37.61

Return Analysis

Target Return	
Current Share Price	13.59
Target Share Price	17.74
Equity Upside	30.54%
12 Month Return	30.54%

Implied Share Price

Exit Multiple

WACC

$17.92	4.9x	5.9x	6.9x	7.9x	8.9x
10.3%	$10.90	$13.21	$15.52	$17.82	$20.13
9.3%	$11.76	$14.22	$16.68	$19.13	$21.59
8.3%	$12.68	$15.30	$17.92	$20.54	$23.16
7.3%	$13.67	$16.46	$19.26	$22.06	$24.86
6.3%	$14.73	$17.72	$20.70	$23.69	$26.68

Sources: FactSet, Estimates

Thank You

Appendix

Enterprise Value	
Present Value of Projected FCF	$1,833.3
Terminal Value	
Terminal Year EBITDA	$4,601.8
Exit Multiple	6.9x
Terminal Value	$31,752.6
Discount Factor	0.57
Present Value of Terminal Value	$18,180.6
% of Enterprise Value	91%
Enterprise Value	$20,013.8

Enterprise Value	
Present Value of Projected FCF	$1,833.3
Terminal Value	
Terminal Year FCF	$1,977.1
Perptual FCF Growth Rate	2.7%
Terminal Value	$35,168.6
Discount Factor	0.57
Present Value of Terminal Value	$20,136.4
% of Enterprise Value	92%
Enterprise Value	$21,969.7

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Management