Third quarter 2011 results
October 27, 2011
Conference call notes

Susan Grey – Director, Investor Relations

Thank you operator and welcome everyone to our third quarter 2011 results conference call.

I would like to refer you to the advisories located at the end of today's news release. In particular, I draw your attention to the risk factors and assumptions outlined in the advisory and discussed further in our annual information form and quarterly reports.

The quarterly results have been presented in Canadian dollars and on a before royalties basis.

Brian Ferguson, President and Chief Executive Officer, will begin with an overview of our results and then turn the call over to John Brannan, Executive Vice-President and Chief Operating Officer, who will provide a summary of our operating performance. Following that, Don Swystun, Executive Vice-President of Refining, Marketing, Transportation and Development, will provide an update on our refining business. Finally, Ivor Ruste, Executive Vice-President and Chief Financial Officer, will discuss our financial performance. Brian will then provide closing comments before we begin the Q&A portion of the call.

Please go ahead Brian.

Brian Ferguson – President & Chief Executive Officer

Thanks Susan. Good morning.

I am pleased to speak to you today about Cenovus's third quarter performance and our outlook for the remainder of the year. We have delivered another strong quarter, highlighted by oil production growth across most of our operations.

We are meeting the milestones we have set for ourselves on or ahead of schedule. We continue to build on our track record of developing our oil resources responsibly, on-time, and at industry leading cost structures. This is critical to building net asset value and increasing total shareholder return.

The most notable operating accomplishment during the third quarter has been first production from our Christina Lake phase C expansion. The teams achieved a steady ramp-up of production over the quarter and we are on track to exit 2011 at production levels in the 35,000 barrels per day range at Christina Lake. This represents production growth of over 90 percent from 2010 exit rates.

Between our two producing oil sands assets, Foster Creek and Christina Lake, we have now commissioned eight phases totaling 178,000 barrels per day of gross production capacity. We have another seven phases under construction, approved by regulators, or sanctioned by partners which will add an additional 265,000 barrels per day. This gives us tremendous visibility on our oil growth plans. We are manufacturing oil growth at a planned pace that will bring on one new phase of production every 12 to 18 months for the coming years. Our phased approach to development allows us to grow production with a tremendous focus on safety, quality, cost, and schedule. We are well on our way to our goal of achieving more than 400,000 barrels per day of oil sands production, net to Cenovus, by the end of 2021.

During the third quarter we demonstrated solid production across our operations. We experienced substantial oil sands growth and a rebound of conventional oil production following a particularly wet spring that impacted our conventional operations. On the conventional oil side we are on track with our growth plans to increase from 70,000 barrels per day to between 120,000 and 130,000 barrels per day. We also continue to experience robust market conditions for our refining operations. John Brannan and Don Swystun will provide more detail on our operational performance in a moment.

Overall strong production and operating performance has translated into strong financial results. We continue to exceed our expectations for cash flow and our balance sheet remains strong, which supports our self-funding business model.

We have provided an update to our guidance as noted in our news release that reflects increased cash flow, capital spending to accelerate oil development projects across our operations, and actual production and commodity prices for the first nine months of the year, as well as projections for the fourth quarter.

I will now turn the call over to our Chief Operating Officer, John Brannan.

John Brannan – Executive Vice-President & Chief Operating Officer

Thank you Brian and good morning.

We had another great quarter across all our operating areas as the teams continue to execute our oil growth strategy. We are on track with full year guidance on production and we have chosen to accelerate capital investment in a few areas for the remainder of the year. Before I review our updated capital plans, I would first like to briefly discuss our operating performance for the quarter.

As mentioned by Brian, we have demonstrated a steady ramp-up of production from our Christina Lake phase C wells. Construction on Phase D is more than 65 percent complete and progressing well. We are also more than 20 percent complete on Christina Lake phase E, as many of the modules have been assembled in our Nisku yard and are currently being shipped to site.

At Foster Creek, we have sustained consistent production levels over the quarter. Based on our performance, we expect to be at the high end of our previous production guidance ranges for oil sands. This is noteworthy in light of the high level of activity currently underway for phases F, G, and H at Foster Creek. We have largely completed earthworks for these three phases and first modules from our Nisku module yard will arriving soon. Concrete and piling work for phase F is underway and detailed engineering activities are almost complete. We are operating our Nisku module yard at full capacity of about 20 modules per month, to support the expansion phases currently under construction at both Foster Creek and Christina Lake.

Our teams were able to catch-up on a number of initiatives that were impacted by weather earlier in the year. We have 3 rigs actively working at our Pelican Lake infill drilling and polymer flood program. We have also been able to drill 40 wells in the Bakken and Lower Shaunavon plays during the quarter. We expect to drill approximately 30 additional wells during the fourth quarter in our Saskatchewan tight oil plays, and we anticipate exiting the year in the 7,200 barrel per day range. This is a slightly lower exit rate than we previously anticipated but reflects second quarter weather related impacts to our development plans. On a full year basis, we expect to be within the previous guidance range for conventional oil production despite earlier weather impacts.

Our natural gas operations continue to generate exceptional free cash flow despite low commodity price levels. During the quarter, we spent $22 million in sustaining capital to generate about $200 million in operating cash flow. These low cost, high return natural gas assets continue to support the funding for the many oil growth opportunities within our portfolio.

We have elected to allocate additional capital to our oil sands and conventional oil growth plays this year, which is fairly evenly split between both areas.

- In the Bakken and Shaunavon areas we will be installing centralized batteries to reduce the impact of spring break-up and lower our overall trucking and transportation costs.
- Next month, we will be putting four additional rig crews to work in southern Alberta, which will then move up to our oil sands for the winter strat well programs. This level loading of work allows us to gain cost efficiencies and secure supply for both rigs and crews.
- In oil sands, we have allocated additional funding mainly to accelerate expansion phases at Foster Creek and Christina Lake. The additional 2011 spending will keep all of our field crews working steadily and allow them to focus on safe and efficient operations.

Overall, our teams have delivered another strong quarter. We continued to advance development of our oil sands growth projects and we made good progress on our conventional programs. We sustained reliable and consistent production levels and most importantly, we did it safely.

I will now turn the call over to Don Swystun for an update on refining and the CORE project. Thank you.

Don Swystun – Executive Vice-President, Refining, Marketing, Transportation & Development

Thanks John.

In the third quarter, Refining and Marketing generated operating cash flow of $238 million. Refining continued to benefit from strong crack spreads, as refined product prices reflect strong global benchmarks and input costs are tied to discounted land-locked crude slates. With access to lower cost feedstock our mid-continent refineries at Wood River and Borger generated very strong margins. Combined utilization at our refineries was 91 percent, an increase from 89 percent during the same period last year, and 90 percent in the second quarter of 2011. Now we report our refining results based on a first-in, first-out or FIFO inventory accounting basis. Using the last-in, first-out accounting method employed by most U.S. refiners, Cenovus's refining operating cash flow would have been $69 million higher or $307 million. This compares to a $74 million positive or upward adjustment to operating cash flow for the second quarter of the year.

Our outlook for refining remains favorable for the near term. We believe the excess supply of crude oil at Cushing will continue to support strong margins at both of our refineries through 2011 and 2012, and we have updated our current guidance to reflect higher operating cash flow expectations for the fourth quarter and the year.

The coker and refinery expansion, or CORE project at Wood River is essentially complete, with all units except the coker fully operational. We are in the process of commissioning the coker and expect to be fully operational by mid-November. The CORE project will add 130,000 barrels per day of heavy oil processing capability and 50,000 barrels per day of overall capacity. This allows us to process more lower cost feedstock, capture the full value chain from oil sands production to finished product, and increase clean product yield - all of which translate into higher profitability at the refinery. Completing this project represents a major milestone and accomplishment for Cenovus and our partner, ConocoPhillips. Based on year-to-date market prices, we anticipate that CORE will provide an approximate U.S. $300 million improvement to operating cash flow on an annualized basis, net to Cenovus.

The CORE project supports our oil production growth plans by expanding heavy oil processing at a location already served by existing pipelines. The CORE project completion is also timely, as the dislocation between feedstock costs and finished products remains a structural benefit for mid-continent refineries. We anticipate that until such time as WTI linked crude slates and waterborne priced crude prices converge, the Wood River refinery will rank as one of the most profitable refineries in North America.

With that, I will turn the call over to Ivor Ruste.

Ivor Ruste – Executive Vice-President & Chief Financial Officer

Thanks Don and good morning everyone.

During the quarter, we reported cash flow of $793 million or $1.05 per share, compared with the $1.08 per share consensus estimate. In order to do this, we generated $945 million of operating cash flow for the quarter based on solid oil production growth from our oil sands assets and strong operating results from our refining business.

In calculating operating earnings, we effectively deduct the costs for DD&A, G&A, finance costs, interest income, and income tax from operating cash flow. Operating earnings for the quarter were $303 million, or $0.40 per share, or about $0.10 per share lower than the consensus street estimate. A higher effective tax rate during the quarter accounted for about half of that shortfall. Despite this quarterly variability, we continue to expect a 32 percent effective tax rate for the full year, excluding the impact of unrealized gains and losses and divestitures.

Operating costs are tracking slightly higher in some areas, but are still in line with our full year guidance expectations. At Christina Lake, operating costs have been impacted by increased staffing costs, higher fuel costs, and increased repairs and maintenance related to phase C startup. We also initiated a turnaround at Christina Lake during the quarter to complete planned regulatory inspections and maintenance for phases A and B. This turnaround had minimal impact on production, but increased operating costs during the quarter by about $2.00 per barrel. We expect operating costs will decrease on a per unit basis as production from phase C continues to build. Operating costs in conventional oil and liquids operations increased as well, reflecting higher workover activity, increased trucking costs, as well as increased salaries and benefits.

Net earnings in the quarter were favorably impacted by the mark-to-market impact of our hedging program which resulted in an unrealized after-tax gain to net earnings of $283 million or $0.37 per share.

Our balance sheet remains in great shape and we exited the quarter at or below the low end of our financial metrics, with a debt to capitalization ratio of 28 percent and debt to adjusted EBITDA of 1.1 times. We have renegotiated our committed bank credit facility, increasing it to $3.0 billion, extending the term by one year and lowering overall borrowing costs. This increases overall liquidity and flexibility for Cenovus. The strength of our balance sheet allows us to fund our oil growth plans while providing a meaningful dividend to our shareholders.

I will now turn the call back to Brian.

Brian Ferguson – President & Chief Executive Officer

Thanks Ivor.

I would like to briefly comment on the recently announced proposed split of ConocoPhillips into two entities and the impact to Cenovus. Cenovus continues to have an integrated business model, which is enhanced with the start-up of CORE that Don Swystun described for you. Within our joint venture, we have separate partnerships with separate management committees. When the proposed split occurs, we will have two partners, not one, which is really the only change. We have ensured that all of the principles and value associated with the integrated strategy has been preserved for Cenovus shareholders in the amended partnership agreements.

This quarter, we have continued to build on our track record of strong financial and operating performance. So far this year, our operating results are somewhat ahead of our expectations, and our updated guidance reflects additional investment within our oil sands and conventional oil growth programs.

We continue to meet or exceed the timing expectations we have set for ourselves to advance our oil growth plans. Accelerating an oil sands phase adds to overall net asset value, so we will continue to look at ways to advance development without compromising safety or our industry leading cost structure. We intend to provide project updates and details on our 2012 plans at our upcoming Investor Day on December 7, so stay tuned.

Our strong balance sheet supports our development and provides the foundation for sustainable dividend increases over time. Our objective is to continue to build net asset value while providing a growing dividend – a focus on total shareholder return.

For the remainder of 2011, we expect to complete our planned capital and drilling programs, and continue to pursue a number of additional milestones, which include:

- Submitting our regulatory application for the Grand Rapids project and a revised application for our Telephone Lake project; and
- Bringing the CORE project at Wood River into full operation

I will also comment on the strategic commercial arrangement that we are currently marketing. As I have previously mentioned, this includes a portion of one of our oil sands leases, including our Telephone Lake resource within the Borealis region and represents a world class opportunity. In September, a confidential information memorandum was released to a number of interested parties. We have recently opened a data room and are undertaking meetings with interested parties.

The Cenovus team is now ready to take your questions.

POST Q&A SESSION

Brian Ferguson – President & Chief Executive Officer

Thank you for joining us for the third quarter conference. Our call is now complete.

ADVISORY
Effective January 1, 2011, Cenovus adopted International Financial Reporting Standards (IFRS). Cenovus's 2011 interim consolidated financial statements and the 2010 comparative information has been prepared under IFRS. The company's consolidated financial statements for the year ending December 31, 2011 must use the IFRS standards in effect on December 31, 2011 and as a result, Cenovus's IFRS accounting policies and the financial information prepared thereunder, are subject to change. Refer to our interim consolidated financial statements and associated MD&A for further information.

NON-GAAP MEASURES
This news release contains references to non-GAAP measures as follows:

- Operating cash flow is defined as revenues, less purchased product, transportation and blending, operating expenses, production and mineral taxes plus realized gains, less losses on risk management activities and is used to provide a consistent measure of the cash generating performance of the company's assets and improves the comparability of Cenovus's underlying financial performance between periods.
- Cash flow is defined as cash from operating activities excluding net change in other assets and liabilities and net change in non-cash working capital from continuing operations, both of which are defined on the Consolidated Statement of Cash Flows in Cenovus's interim consolidated financial statements.
- Operating earnings is defined as net earnings excluding non-operating items such as the after-tax impacts of a gain/loss on discontinuance, the gain on asset acquisition, the after-tax gain/loss of unrealized mark-to-market accounting for derivative instruments, the after-tax gain/loss on translation of U.S. dollar denominated notes issued from Canada and the partnership contribution receivable, the after-tax foreign exchange gain/loss on settlement of intercompany transactions, after-tax gains or losses on divestiture of assets, deferred income tax on foreign exchange related to U.S. dollar intercompany debt recognized for tax purposes only and the effect of changes in statutory income tax rates. Management views operating earnings as a better measure of performance than net earnings because the excluded items reduce the comparability of the company's underlying financial performance between periods. The majority of the U.S. dollar debt issued from Canada has maturity dates in excess of five years.
- Free cash flow is defined as cash flow in excess of capital investment, excluding net acquisitions and divestitures, and is used to determine the funds available for other investing and/or financing activities.
- Debt to capitalization and debt to adjusted EBITDA are two ratios that management uses to steward the company's overall debt position as measures of the company's overall financial strength. Debt is defined as short-term borrowings and long-term debt, including the current portion, excluding any amounts with respect to the partnership contribution payable and receivable. Capitalization is a non-GAAP measure defined as debt plus shareholders' equity. Adjusted EBITDA is defined as adjusted earnings before finance costs, interest income, income taxes, depreciation, depletion and amortization, exploration expense, unrealized gain or loss on risk management, foreign exchange gains or losses, gains or losses on divestiture of assets and other income and loss.

These measures have been described and presented in this news release in order to provide shareholders and potential investors with additional information regarding Cenovus's liquidity and its ability to generate funds to finance its operations. For further information, refer to Cenovus's most recent MD&A available at www.cenovus.com.

FORWARD-LOOKING INFORMATION

This news release contains certain forward-looking statements and other information (collectively "forward-looking information") about our current expectations, estimates and projections, made in light of our experience and perception of historical trends. Forward-looking information in this news release is identified by words such as "anticipate", "believe", "expect", "plan", "forecast", "target", "project", "could", "focus", "vision", "goal", "proposed", "scheduled", "outlook", "potential", "may" , "looking forward to", or similar expressions and includes suggestions of future outcomes, including statements about our growth strategy and related schedules, projected future value or net asset value, forecast operating and financial results, planned capital expenditures, expected future production, including the timing, stability or growth thereof, expected future refining capacity, anticipated finding and development costs, expected reserves and contingent and prospective resources estimates, potential dividends and dividend growth strategy, anticipated timelines for future regulatory, partner or internal approvals, future impact of regulatory measures, forecasted commodity prices, future use and development of technology, including technology and procedures to reduce our environmental impact, and projected increasing shareholder value. Readers are cautioned not to place undue reliance on forward-looking information as our actual results may differ materially from those expressed or implied.
Developing forward-looking information involves reliance on a number of assumptions and consideration of certain risks and uncertainties, some of which are specific to Cenovus and others that apply to the industry generally.

The factors or assumptions on which the forward-looking information is based include: assumptions inherent in our current guidance, available at www.cenovus.com; our projected capital investment levels, the flexibility of capital spending plans and the associated source of funding; estimates of quantities of oil, bitumen, natural gas and liquids from properties and other sources not currently classified as proved; ability to obtain necessary regulatory and partner approvals; the successful and timely implementation of capital projects; our ability to generate sufficient cash flow from operations to meet our current and future obligations; and other risks and uncertainties described from time to time in the filings we make with securities regulatory authorities.

The risk factors and uncertainties that could cause our actual results to differ materially, include: volatility of and assumptions regarding oil and gas prices; the effectiveness of our risk management program, including the impact of derivative financial instruments and the success of hedging strategies; accuracy of cost estimates; fluctuations in commodity prices, currency and interest rates; fluctuations in product supply and demand; market competition, including from alternative energy sources; risks inherent in our marketing operations, including credit risks; maintaining desirable ratios of debt to adjusted EBITDA as well as debt to capitalization; our ability to access external sources of debt and equity capital; accuracy of our reserves, resources and future production estimates; our ability to replace and expand oil and gas reserves; the ability of us and ConocoPhillips to maintain our relationship and to successfully manage and operate our integrated heavy oil business; reliability of our assets; potential disruption or unexpected technical difficulties in developing new products and manufacturing processes; refining and marketing margins; potential failure of new products to achieve acceptance in the market; unexpected cost increases or technical difficulties in constructing or modifying manufacturing or refining facilities; unexpected difficulties in producing, transporting or refining of crude oil into petroleum and chemical products; risks associated with technology and its application to our business; the timing and the costs of well and pipeline construction; our ability to secure adequate product transportation; changes in Alberta's regulatory framework, including changes to the regulatory approval process and land-use designations, royalty, tax, environmental, greenhouse gas, carbon and other laws or regulations, or changes to the interpretation of such laws and regulations, as adopted or proposed, the impact thereof and the costs associated with compliance; the expected impact and timing of various accounting pronouncements, rule changes and standards on our business, our financial results and our consolidated financial statements; changes in the general economic, market and business conditions; the political and economic conditions in the countries in which we operate; the occurrence of unexpected events such as war, terrorist threats and the instability resulting therefrom; and risks associated with existing and potential future lawsuits and regulatory actions against us.

Readers are cautioned that the foregoing lists are not exhaustive and are made as at the date hereof. For a full discussion of our material risk factors, see "Risk Factors" in our most recent annual information form, available at www.cenovus.com. Readers should also refer to "Risk Management" in our current MD&A and to the risk factors described in other documents we file from time to time with securities regulatory authorities, available at www.sedar.com, www.sec.gov and www.cenovus.com.

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