Fourth quarter and year-end 2016 results
February 16, 2017
Conference call notes

Kam Sandhar – Vice-President, Investor Relations & Corporate Development

Thank you operator and welcome everyone to our fourth quarter 2016 results conference call.

I would like to refer you to the advisories located at the end of today's news release. These advisories describe the forward looking information, non-GAAP measures and oil and gas terms referred to today, and outline the risk factors and assumptions relevant to this discussion. Additional information is available in our most recent Annual Information Form or Form 40-F. Due to recent industry guidance, we have relabeled Cash Flow as Adjusted Funds Flow; Operating Cash Flow as Operating Margin; and Free Cash Flow as Free Funds Flow. There has been no change to the composition of these measures.

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

We have also posted a link to our quarterly results, on the home page of our website at cenovus.com.

Brian Ferguson, our President and Chief Executive Officer, will provide brief comments, and then we will turn to the Q&A portion of the call with Cenovus's Leadership team.

Please go ahead Brian.

Brian Ferguson – President & Chief Executive Officer

Thanks Kam. Good morning everyone.

I'm pleased to report today that we delivered another solid quarter. Oil sands production was up, reserves are up, operating costs are down, capital costs are down, finding and development costs are down and our balance sheet is strong.

2016 brought heightened commodity price volatility. Cenovus proved its resilience and ended the year in a very strong position.

Early in 2016, we discussed our plans for significant oil sands sustaining program and the start-up of two expansion phases, all while maintaining a focus on cost improvement.

As you can see from our results today, both capital and operating costs came in under budget as our teams drove efficient execution and applied a manufacturing approach.

You may remember that last year at this time we were planning a focused well maintenance program and the completion and start-up of seven new well pads at Foster Creek. The successful execution of that work, combined with the on-time start-up of phase G in the third quarter, resulted in fourth quarter average daily production of over 81,000 barrels per day. Foster Creek continues to be a cornerstone asset.

Non-fuel operating costs at Foster Creek averaged about $8.10 per barrel in 2016, that's compared with our original guidance of $10 to $11.50 per barrel. That's a 17 percent decrease relative to 2015. These reductions are related to lower workforce costs, the deferral of a planned turnaround and maintenance optimization.

As discussed in our 2017 budget conference call, the start-up of the new pads at Foster Creek extends through the end of last year, with incremental production continuing to ramp-up in 2017.

Christina Lake also enjoyed another year of strong performance. Production grew by six percent. Non-fuel operating costs came in better than expected at $5.40 per barrel, well below our original guidance of $6 to $8.50 per barrel, and a seven percent reduction compared to 2015. This performance was mainly driven by reduced workforce costs and maintenance optimization.

Since our planned turnaround in October, and following the safe and successful start-up of Christina Lake phase F in the fourth quarter, we've experienced an accelerated ramp-up of production that we expect to continue throughout this year. Our new cogen facility is up and running, providing a secure source of power for Christina Lake, and we're selling excess power into the grid.

We expect that the ramp-up of the Foster Creek and Christina Lake expansion phases will drive oil sands production growth of approximately 19 percent this year.

We recently announced that we intend to resume investment in the Christina Lake phase G expansion. Module assembly resumed in the fourth quarter of 2016, with field construction expected to ramp-up by mid-year as modules arrive at site. We will continue to focus on disciplined growth, in areas where we can add value and increase cash flow. As Kam said, that is now known as adjusted funds flow. With more moderated industry activity levels compared to prior years, we think that this is a great time for us to be countercyclical and invest in our top-tier asset base.

Our conventional oil and gas portfolio remains the most flexible component of our capital and continues to generate significant free funds flow to invest in our oil sands business. In 2016, our conventional assets generated over $540 million in operating margin, or approximately $370 million in operating margin in excess of capital investment.

Downstream performance for the year was also good. Despite seasonally lower crack spreads in the fourth quarter, refining benefited from cheaper feedstock purchased earlier in the year. The refining and marketing segment generated $346 million in operating margin for the full year, or about $126 million in operating margin in excess of related capital investment. Integration remains an important part of our strategy to help stabilize corporate cash flow in times of fluctuating oil price and differentials.

Cenovus added 221 million barrels of oil equivalent of proved reserves in 2016, that's production replacement of 220 percent. These additions were primarily bitumen reserves, and were driven by the expansion of the development area at Christina Lake and improvements in reservoir performance at both Foster Creek and Christina Lake. These additions translated to proved finding and development costs of $3.49 per barrel of oil equivalent for the year, and generated a recycle ratio of approximately 3.2 times.

More importantly, the independent qualified reserve evaluators, or IQREs, have now begun to recognize and book the success that we have had on reducing costs. The IQRE's estimate of future development costs on our undeveloped proved bitumen reserves dropped 11 percent to approximately $8.00 per barrel in 2016. We expect that demonstrated improvements in our cost structure and the shift in our reservoir management strategy, utilizing longer wells with wider spacing, should result in our IQREs continuing to recognize cost improvements in 2017 and beyond.

We continue to do further engineering and design work on our other deferred oil sands expansions and will provide an update, including cost estimates and project timing for both Foster Creek phase H and Narrows Lake phase A, at our Investor Day in June. Defining these opportunities, as well as other developments, will provide clear visibility to our investment plans through 2020 and beyond.

I am confident and I am optimistic about our prospects for the year ahead.

With that, the Cenovus Leadership team and I are ready to take questions.

ADVISORY

FINANCIAL INFORMATION

Basis of Presentation Cenovus reports financial results in Canadian dollars and presents production volumes on a net to Cenovus before royalties basis, unless otherwise stated. Cenovus prepares its financial statements in accordance with International Financial Reporting Standards (IFRS).

Non-GAAP Measures This news release contains references to adjusted funds flow (previously labelled cash flow), operating earnings (loss), free funds flow (previously labelled free cash flow), net debt to adjusted EBITDA and net debt to capitalization. These are non-GAAP measures, which do not have standardized meanings and may not be comparable to similar measures presented by other issuers. Adjusted funds flow, operating earnings (loss) and free funds flow are defined and reconciled to IFRS measures in the Financial Results section of the company's Management's Discussion and Analysis for the year ended December 31, 2016 (the "MD&A"). Net debt to adjusted EBITDA and net debt to capitalization are defined and reconciled to IFRS measures in the Liquidity and Capital Resources section of the MD&A. These non-GAAP measures are presented because they are used by management to analyze Cenovus's liquidity and ability to generate funds to finance its operations. This information should not be considered in isolation or as a substitute for measures prepared in accordance with IFRS. For further information, refer to the MD&A.

Cenovus previously identified operating cash flow (now relabelled operating margin) as a non-GAAP measure. However, the company has determined that this measure is more appropriately characterized as an additional subtotal, as it is found in note 1 of the company's consolidated financial statements for the year ended December 31, 2016 (the "Financial Statements"). Cenovus has not changed the composition of the measure. For more information regarding operating margin, refer to note 1 of the Financial Statements:

Oil and Gas Metrics

F&D costs are calculated by dividing the sum of total exploration and development costs incurred in 2016 by the sum of total additions and revisions for proved reserves in the same period. Proved reserves additions and revisions for the period are determined by Cenovus's independent qualified reserves evaluators, effective December 31, 2016, and for purposes of determining F&D costs, exclude changes resulting from acquisitions, dispositions and production. F&D costs provide an indication of the unit cost of finding and developing new reserves.

Recycle ratio is an approximate measure used to illustrate the value realized from selling a barrel of oil relative to the cost of adding a barrel of oil to reserves. Recycle ratio is defined as the Operating Netback (in $/BOE for the year) divided by the F&D (in $/BOE). Operating Netback is defined as production revenues, excluding realized gains and losses on commodity hedging, less royalties, production and mineral taxes, transportation and production expenses, calculated on a per BOE basis.

Barrels of oil equivalent Natural gas volumes have been converted to barrels of oil equivalent (BOE) on the basis of six Mcf to one barrel. BOE may be misleading, particularly if used in isolation. A conversion ratio of one bbl to six Mcf is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil compared with natural gas is significantly different from the energy equivalency conversion ratio of 6:1, utilizing a conversion on a 6:1 basis is not an accurate reflection of value.

FORWARD-LOOKING INFORMATION

This news release contains certain forward-looking statements and other information (collectively "forward-looking information") about Cenovus's current expectations, estimates and projections, made in light of the company's experience and perception of historical trends. Forward-looking information in this document is identified by words such as "anticipate", "expect", "estimate", "plan", "target", "position", "project", "committed", "can be", "pursue", "capacity", "potential", "may", "on track", "confidence" or similar expressions and includes suggestions of future outcomes, including statements about: milestones and schedules, including expected timing for oil sands expansion phases and associated expected production capacities; projections for 2017 and future years; forecast operating and financial results; planned capital expenditures; expected future production, including the timing, stability or growth thereof; our ability to preserve our financial resilience and plans and strategies with respect thereto; our expectations regarding growth from our planned oil sands expansions, construction and potential restarts, and future impacts to our oil sands production capacity; achieved and forecast cost reductions, including sustainability and expected impacts thereof; and expected impacts of our hedging program. 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: forecast oil and natural gas prices and other assumptions inherent in Cenovus's current guidance, available at cenovus.com; projected capital investment levels, flexibility of capital spending plans and associated source of funding; future cost reductions; sustainability of cost reductions; expected condensate prices; estimates of quantities of oil, bitumen, natural gas and liquids from properties and other sources not currently classified as proved; future use and development of technology; ability to obtain necessary regulatory and partner approvals; successful and timely implementation of capital projects or stages thereof; the company's ability to generate sufficient cash to meet its current and future obligations; estimated abandonment and reclamation costs, including associated levies and regulations; and other risks and uncertainties described from time to time in the company's filings with securities regulatory authorities.

2017 guidance, as updated on December 8, 2016, assumes: Brent of US$48.75/bbl; WTI of US$47.25/bbl; WCS of US$31.50/bbl; NYMEX of US$3.00/MMBtu; AECO of $2.60/GJ; Chicago 3-2-1 crack spread of US$11.25/bbl; and an exchange rate of $0.74 US$/C$.

The risk factors and uncertainties that could cause the company's actual results to differ materially include: volatility of and assumptions regarding oil and natural gas prices; the effectiveness of the company's risk management program, including the impact of derivative financial instruments, the success of hedging strategies and the sufficiency of liquidity position; accuracy of cost estimates; commodity prices, currency and interest rates; product supply and demand; market competition, including from alternative energy sources; risks inherent in Cenovus's marketing operations, including credit risks; exposure to counterparties and partners, including ability and willingness of such parties to satisfy contractual obligations in a timely manner; risks inherent in operation of the company's crude-by-rail terminal, including health, safety and environmental risks; maintaining desirable ratios of debt to adjusted EBITDA and net debt to adjusted EBITDA as well as debt to capitalization and net debt to capitalization; ability to access various sources of debt and equity capital, generally, and on terms acceptable to Cenovus; ability to finance growth and sustaining capital expenditures; changes in credit ratings applicable to Cenovus or any of its securities; changes to dividend plans or strategy, including the dividend reinvestment plan; accuracy of reserves, resources and future production estimates; ability to replace and expand oil and gas reserves; ability to maintain relationships with partners and to successfully manage and operate the company's integrated business; reliability of assets, including in order to meet production targets; potential disruption or unexpected technical difficulties in developing new products and manufacturing processes; occurrence of unexpected events such as fires, severe weather conditions, explosions, blow-outs, equipment failures, transportation incidents and other accidents or similar events; refining and marketing margins; inflationary pressures on operating costs, including labour, natural gas and other energy sources used in oil sands processes; potential failure of products to achieve acceptance in the market; risks associated with fossil fuel industry reputation; 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 Cenovus's business; risks associated with climate change; the timing and costs of well and pipeline construction; ability to secure adequate product transportation, including sufficient pipeline, crude-by-rail, marine or other alternate transportation, including to address any gaps caused by constraints in the pipeline system; availability of, and ability to attract and retain, critical talent; changes in labour relationships; changes in the regulatory framework in any of the locations in which Cenovus operates, including changes to the regulatory approval process and land-use designations, royalty, tax, environmental (including in relation to abandonment, reclamation and remediation costs, levies or liability recovery with respect thereto), 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 Cenovus's business, financial results and consolidated financial statements; changes in the general economic, market and business conditions; the political and economic conditions in the countries of operation; 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.

Readers are cautioned that the foregoing lists are not exhaustive and are made as at the date hereof. For a discussion of Cenovus's material risk factors, see “Risk Factors” in the company's AIF or Form 40-F for the year ended December 31, 2016, available on SEDAR at sedar.com, EDGAR at sec.gov and the company's website at cenovus.com.

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