FINAL TRANSCRIPT

Cenovus Energy Inc.

Third Quarter Results Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to Cenovus Energy's third quarter results.

As a reminder, today's call is being recorded.

At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. You can join the queue at any time by pressing *, 1. Members of the investment community will have the opportunity to ask questions first. At the conclusion of that session, members of the media may then ask questions.

Please be advised that this conference call may not be recorded or rebroadcast without the expressed consent of Cenovus Energy.

I would now like to turn the conference over to Miss Sherry Wendt, Vice-President, Investor Relations. Please go ahead, Miss Wendt.

Sherry Wendt — Vice-President, Investor Relations, Cenovus Energy Inc.

Thank you, Operator, and welcome, everyone, to Cenovus's 2021 third quarter results conference call.

I'll refer you to the advisories located at the end of today's news release. These 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 Cenovus's annual MD&A and our most recent Annual Information Form and Form 40-F.

All figures are presented in Canadian dollars and before royalties, unless otherwise stated.

Alex Pourbaix, our President and Chief Executive Officer, will provide brief comments, and then we will take your questions. We ask that you please hold off on any detailed modelling questions and instead follow up on those directly with our Investor Relations team after the call. And if you could please keep to one question with a maximum of one follow-up. You can rejoin the queue for any other questions.

Alex, please go ahead.

Alex Pourbaix — President and Chief Executive Officer, Cenovus Energy Inc.

Thanks, Sherry, and good morning, everybody. First, let me update everyone on our current response to COVID-19, which remains a challenge in all of the jurisdictions where we operate.

We continue to encourage full vaccination for all of our staff, and we're following the latest advice from public health officials, government, and our own health and safety experts. That includes continued rapid testing at a number of our field locations and mandatory work-from-home for office and other staff who are able to do so, where required by local health officials.

In addition, in alignment with recent direction from the Canadian government, we are now requiring proof of full vaccination as of October 30 for travel on all Cenovus scheduled and ad hoc flights to and from our sites, including charter, company-owned aircraft, and helicopter flights. As we modify protocols at our operations, we'll continue to follow public health guidance and work closely with governments, health authorities, and industries to protect our people.

Safety is foundational to how we operate. I was disappointed by our safety performance and particularly our process safety performance immediately after closing the Husky deal. We learned from these events and took rapid actions to strengthen our combined safety culture.

Since then, and throughout the second and third quarters, we've seen significant improvement in our safety performance. For example, we cut in half the frequency of process safety incidents in these periods compared to the first quarter. As another example, our conventional business did not have a single recordable occupational injury in the first nine months of this year.

However, despite these improvements, we've had a couple of concerning safety incidents very recently. These serve as important reinforcement that we must be unrelenting in our top-tier safety journey. At Cenovus, there is no priority more important than safety and continuing to do everything we can to make sure everyone goes home safely every day.

Turning now to our third quarter results. By now, you've all seen our plans to increase shareholder returns, and I'm sure everybody is keen to talk a little more about that. Before we turn to that, though, why don't we start with the operating results that drove this quarter's financial results and led to that shareholder returns announcement. I'm incredibly proud of the accomplishment of our operations teams and assets this quarter and year-to-date.

In the upstream segment, we continue to deliver consistent and strong operating performance, with total production of nearly 805,000 BOE per day in the third quarter, an increase of 5 percent over the second quarter. This production increase was led by record single-day and quarterly average production rates at both Foster Creek and Christina Lake.

Production at Christina Lake averaged about 243,000 barrels per day in the third quarter, a 5 percent increase over the prior record set in the second quarter. This reflected redevelopment and redrill wells coming online in the quarter. These redevelopment wells are high return, short-cycle projects we'd included in the capital budget this year and reflect the kind of opportunities that exist for Christina Lake.

Moving to Foster Creek now. You might remember that on our second-quarter conference call I talked about some emulsion treating issues we had coming out of the turnaround, which impacted production into July. As we discussed in the Q2 call, the teams quickly incorporated learnings and returned Foster Creek to full rates as of mid-July.

With our Q3 results, we're pleased to report that the teams not only recovered Foster to full rates, but went on to deliver production of over 200,000 barrels per day from the asset in each of August and September. For perspective, remember that Foster Creek is an asset with a nameplate capacity of 180,000 barrels per day. This is just another demonstration of our industry-leading asset quality and operating expertise in the oil sands.

Turning to the Lloydminster thermal projects. The benefits of applying Cenovus's operating techniques continued to be demonstrated, and the assets delivered an average of about 98,000 barrels per day in the third quarter. Oil sands operating performance combined with strong realized pricing to deliver segment operating margin of nearly $2 billion, driving the Company's total operating margin of $2.7 billion for the quarter.

Oil sands unit operating costs decreased relative to the second quarter, mainly due to increased production from the well pads we brought online and the turnaround activity in the second quarter.

Looking at our conventional business, production was down about 7 percent relative to the second quarter, primarily due to the impact of asset sales, as well as an unplanned third-party processing plant outage.

Even with lower production volumes, unit operating costs for conventional held flat relative to the second quarter as the business delivered nearly $200 million of operating margin. This was 35 percent higher than the second quarter operating margin, with the increase driven by increased realized prices and high production on time.

Our offshore operations continue to be a strong contributor to free funds flow, delivering operating margin of nearly $330 million in the quarter and operating margin totalling over $1 billion so far this year. Asia Pacific operations continued performing well with daily production of 60,000 BOE per day in the third quarter, which was in line with the second quarter.

Production rose in Indonesia in response to strong demand, offsetting production impacts of planned maintenance and assets in China during the quarter. And as previously announced in respect of our Atlantic business, we received about $75 million during the quarter from exiting partners as a contribution towards future decommissioning liabilities with a restructuring of working interest in the Terra Nova field.

Moving to the downstream segments. In Canadian Manufacturing, reliable operating performance continued at the Lloyd Upgrader and Asphalt Refinery with an average utilization of 98 percent. While utilization and unit refining margins at the Upgrader and Lloyd Refinery were slightly higher than the second quarter, total operating margin of $130 million was about $60 million lower than in Q2 for Canadian Manufacturing. The difference was about the amount of a settlement recorded in the second quarter on a customer contract at Bruderheim crude-by-rail terminal.

In U.S. Manufacturing, refinery utilization averaged 89 percent in the quarter, which was 2 percent higher than the second quarter. This included the impact of some turnaround activity and other minor unplanned outages at some of our partner-operated joint venture refineries during the quarter.

Unit operating costs held about flat relative to the second quarter, while unit refining margin increased about 7 percent to $13.45 per barrel. This included the average unit cost of RINs decreasing by about 10 percent from the second quarter to about $7.30 per barrel for the quarter. And just, I'd remind everybody to keep in mind that's still nearly 3 times the average unit cost for RINs in the third quarter a year ago.

I'll take a moment to discuss in a little more detail our U.S. refining assets where we are operator. At the Lima Refinery, recall that throughput rates began ramping up in the second quarter following unplanned outages earlier in the year. In the third quarter, we achieved crude utilization of 93 percent at the Lima refinery. We've been pleased to see performance stabilizing at the refinery, which reflects the Lima's team focus on base operations.

We slowed production at the Lima Refinery at the end of September in preparation for a planned turnaround we're completing in the fourth quarter. As we've said previously, this is a large turnaround, so it's fair to expect that throughputs will be lower in Q4 as a result.

Closing out the discussion of U.S. refining, I'm pleased to report that the Superior Refinery rebuild construction continues to proceed well. Capital spend remains on track, and we still expect rebuild costs to be largely offset by insurance. There is no change to our expectations for the refinery to be ramped back up in early 2023.

Focusing on sustainability, we continue critical work on emissions reduction for our company and the broader industry through the Oil Sands Pathways to Net Zero initiative co-founded by Cenovus. Pathways is currently advancing its foundational carbon capture utilization and storage project, which will have phased capacity to transport carbon from more than 20 oil sands operations to a safe storage hub. In addition, the Pathways teams are analyzing other technology opportunities to address GHG emissions in the oil sands.

Meanwhile, we're working with both levels of government to ensure the necessary policy and financial support is in place to achieve the Pathways' vision and help Canada achieve its climate and economic recovery goals. We look forward to sharing more on this and our updated targets for our ESG focus areas at our virtual investor day to be held on December 8th.

Turning now to our financial results for the quarter. Our strong operating performance combined with rising commodity prices to drive solid financial outcomes. And while it's true that a rising tide lifts all boats, Cenovus maximized the opportunity by increasing oil sands production and optimizing our pipeline capacity to make the most of higher prices. This supported the generation of cash from operating activities of $2.1 billion, adjusted funds flow of $2.3 billion, and free funds flow of $1.7 billion during the quarter.

We also took the opportunity to deleverage as quickly as possible. As promised, we applied free funds flow to the balance sheet, and we completed strategic financing transactions in the quarter aimed at deleveraging. These transactions extended the overall maturities profile as we executed public offerings of 10- and 30-year notes at attractive rates, while repurchasing a portion of our nearer-term maturity notes. These transactions supported deleveraging and helped reduce financing risk in the near term.

In addition, we leveraged the strong market to progress several asset sales during the quarter. This included the sale of our shares of Headwater Exploration for net proceeds of nearly $220 million announced in the quarter with proceeds received shortly after quarter-end.

We also closed previously announced asset sales in the East Clearwater and Kaybob areas for combined gross proceeds of about $110 million. All of this has led to Cenovus deleveraging faster than anyone could have imagined a year ago.

We finished the third quarter with net debt of about $11 billion, a reduction of $1.4 billion since the end of the second quarter. And today, we are very close to achieving our interim net debt target of below $10 billion, which takes me to our shareholder returns announcement.

We've been clear that increasing shareholder returns would be our first priority upon reaching our interim net debt target. Delivering on that commitment, our Board has approved doubling the dividend on our common shares effective for the fourth quarter dividend to $0.14 per share[1]. In addition, the board has approved filing of an NCIB application with the TSX for a share buyback program of up to about 150 million common shares, which we expect to commence following achievement of net debt below $10 billion.

We'll provide more context on how we think about capital allocation at our virtual Investor Day on December 8th. However, as we've said previously, when we're below $10 billion net debt, you should expect to see a more balanced approach to free funds flow application between further deleveraging and shareholder returns. And at current commodity prices, we would expect to be able to execute our buyback plan in 2022 while achieving net debt under $8 billion around midyear. This disciplined approach will also support our commitment to achieving mid-BBB investment-grade ratings over time.

In closing, this quarter has once again reinforced the strength of our business, including the benefits of our best-in-class assets and reliable operating performance, as well as the financial results driven by those operations. I think it has also, once again, demonstrated this company's discipline to delivering on our goals.

So with that, we're happy to take your questions.

[1.] $0.14 per share is the annual dividend; quarterly dividend is $0.035 per share.

Q&A

Operator

Ladies and gentlemen, as a reminder, you can join the queue to ask a question by pressing *, 1. We'll now begin the question-and-answer session and go to the first caller.

We'll take our first question from Greg Pardy with RBC.

Greg Pardy — RBC

Yeah. Thanks. Good morning. Thanks for the rundown, Alex. Couple of questions for you. The first one is probably just surrounding your appetite for organic investment once you hit that $8 billion target. Let's just say that that's kind of mid next year. How does the modus operandi begin to change at Cenovus?

Alex Pourbaix

I think when you talk about organic investment, Greg, and I think I talked about this a little bit at the last quarter, but I think one of the things—and I might at some point turn this over to Jon to talk a little bit too—but one of the things that I think has been our huge positive out of the Husky transaction is we are finding very, very significant opportunities to grow production, improve our profitability, and these are largely what I would call smaller greenfield or brownfield-type opportunities coming out of our existing asset base. And so I think that's going to be a continued focus area with us.

The other thing I would say, before I turn it over to Jon, is with the advances the Company has made in our operating strategies, it's just really, really unlikely, I think, that you're going to see this company announcing any large-scale greenfield developments any time in the near to medium term. A great example, I think, would be Narrows Lake. That was a project that for decades was thought of in this company and, frankly, construction started on it as a stand-alone greenfield facility. And we've made so many advances in our ability to move emulsion and steam long distances that we are going to develop Narrows Lake, but it's really going to be developed as pads at Narrows Lake with the emulsion being brought back to Christina Lake for processing and treating.

And those kinds of advances just give us an opportunity to massively reduce the capital associated with these sorts of facilities.

But maybe I'll turn it over to Jon. I know he has some thoughts.

Jon McKenzie — Executive Vice-President and Chief Operating Officer, Cenovus Energy Inc.

Yeah. Good morning, Greg. It's Jon. And maybe one of the things that I would just remind you is just some of the principles we have around organic investment. And a couple of those that are core to this company are any investment that we put into the ground has to return a cost of capital return at $45 WTI or $1.70 gas.

And I'd secondly, I guess, remind you that in terms of sustaining capital, a good run rate for this company is still in that $2.4 billion range. But one of the things that we've been really looking at, particularly with the asset base that we've inherited and then again with our own assets, is what are the real short-cycle opportunities that we have that don't require a lot of capital and generate cost of capital returns well and above $45 that we have available to us. And you've seen some of those this quarter in Foster Creek and Christina.

And we're working in our Deep Basin assets, as well as our heavy oil assets, to identify even more of those kinds of opportunities. And we think we've built a pretty good backlog of those kind of short-cycle, low-capital brownfield-type debottlenecking opportunities that we have that are really high return.

So I would say that we've been pretty clear on what we're doing on our capital going forward, and you shouldn't expect a left-hand turn from what we've talked about before, which is largely a sustaining capital budget with some marginal increases going forward. But we have lots of opportunities, I think, across the asset base on that kind of a paradigm.

Greg Pardy

Okay. Terrific. Thanks for clarifying that. And then just on the non-core asset set, I know you'd indicated in the release you've done around $440 million. You've got lots of irons in the fire. What I'm curious about is whether the sharp escalation in oil price is actually making non-core asset sales harder from a bid-ask perspective? But any colour around the processes underway would be great.

Alex Pourbaix

No. I mean, my general observation is that sort of trend to higher commodity prices has kind of been with us for quite some time, and I think it's actually helped us in terms of creating some competitive tension for those non-core assets. And I think as you're in these processes, I would say as commodity prices rise, our expectation of value commensurately rises. And I'm quite happy at the state that we are at with our non-core asset divestiture program.

Greg Pardy

Okay. Thanks very much, Alex. Thanks, Jon.

Alex Pourbaix

Yeah. Thanks, Greg.

Operator

We'll take our next question from Menno Hulshof with TD Securities.

Menno Hulshof — TD Securities

Thanks, and good morning, everyone. Just I'll start with a question on the balance sheet. And like Greg, I see you getting to rough numbers, $8 billion of net debt towards the middle of next year. So my question is, can we assume that the plan is to reset that to $6 billion? And more generally, what is the end game for the balance sheet beyond a mid-BBB IG rating? And how are you balancing that against buyback activity?

Alex Pourbaix

Well, I think in terms of ultimately where we want to get to, we're doing a lot of work on that. Right now, our kind of professed target is $8 billion. And as you make a point, Menno, I think if you take a look at your model, you take a look at prevailing market prices, you can see us hitting that sometime mid next year and that's without giving any credence to asset divestitures. So we think that there's an opportunity to hit that target in very, very short order.

And I think, from my perspective, that the one thing I've learned about this business in my four years running the Company is a pristine balance sheet, and Jon calls it the fortress balance sheet, is incredibly important as part of our strategy. I think at $8 billion we're in pretty good shape, but you won't see me cry any tears if at moments of time we're below that number. And we'll probably be able to give a little more guidance as we head into our Investor Day in December.

Anything to add on that, Jeff?

Jeff Hart — Executive Vice-President and Chief Financial Officer, Cenovus Energy Inc.

No. I think you hit it, Alex. And in the long term, I think we feel the mid-BBB is really the sweet spot, and we've always articulated is $8 billion is more of a ceiling, but we'd want to hold that through the cycle. And between $10 billion and $8 billion we'll be balanced between shareholder returns and deleveraging. And then we'll re-balance from there sub-$8 billion.

And just to note in the quarter, our net debt did go down $1.4 billion, but I think as you see that, to Alex's point, is we're very conscious of balancing liquidity, maturities, and de-risking the portfolio. So we took the opportunity here in Q3 really to de-risk that, and if you look at it, really extend our bond term by about three years and really balance out that portfolio and de-risk near-term maturities as well.

Menno Hulshof

Terrific. Thanks for that. And so my second question, I believe, is for Jon. Jon, I think you talked about rethinking some of your non-operated JVs within your refinery portfolio on the last call. And I think your wording was whether they were held within the right vehicle. Do you have any updated thoughts on that? And how much of a priority is that process?

Jon McKenzie

I think, Menno, we're always challenging our thinking on that. And we're always, I think, progressing how we're thinking about the downstream and whether non-operated joint ventures are the right vehicles to hold our refining assets in.

What I would tell you during the quarter is we've been pretty focused on our knitting, and we've talked about synergy capture and deleveraging and getting our dispositions completed. So it's something we continue to think about, but I'd say in the short term our priorities are pretty clear around the balance sheet, managing costs, and ensuring that we exit this year where we want to be on both of those counts.

Menno Hulshof

Thanks a lot, Jon.

Operator

And we'll take our next question from Neil Mehta with Goldman Sachs.

Carly Davenport — Goldman Sachs

Hi. Good morning. This is Carly on for Neil. Thanks for taking the questions, and congrats on the good quarter. The first one was just around the buyback and great to see that the incremental capital returns announced there. Can you just talk a little bit about how you're thinking about the pace of the buyback going forward as we move into '22?

Alex Pourbaix

Sure. And hopefully, I can help a little bit. I'm not sure the answer will be completely satisfactory, but I always say we endeavour always to do exactly what we say we're going to do. And you'll recall that I have been saying that we will not buy back shares until we hit our $10 billion net debt target. People should not think of that as a 2022 exercise. Our reaching $10 billion is imminent and at that point I'll feel that we have fulfilled that commitment in the market.

And I'm not sure. I think everybody should understand we are very, very serious about the share buyback. We wouldn't have announced it if we weren't. And we've announced an intention to complete that share buyback by the end of 2022. Beyond that, there's obviously going to be puts and takes in market conditions. But it is our intention to execute it by the end of 2022. And I don't think I'm able to give you much more granularity beyond that other than it's a pretty big number, it's a pretty large commitment, and it's going to take a while to do it. So you can expect that we'll be pretty active on it.

Carly Davenport

Great. That's helpful. Thank you. And then the follow-up was just kind of around the assets. You guys have made a lot of progress at assets like Lloyd since applying some of the Cenovus best practices to those operations and just wanted to get your latest sense on if there are any other opportunities that you've identified to drive optimization at the legacy Husky assets?

Norrie Ramsay — Executive Vice-President, Upstream, Cenovus Energy Inc.

Yup. This is Norrie Ramsay here. I run the upstream part of this portfolio. Yup. We're very pleased. We've been applying our Foster Creek and Christina Lake processes over to Lloyd. We actually see we're just scratching the surface at the moment. We see lots and lots of opportunities.

We've been able to apply them at Lloyd firstly. That's been the priority. We've been spending capital there, and we've been reducing the spend rate, which has been really good.

We've also been doing a lot of surveillance of the wells and we see a huge portfolio of opportunities. And we intend to apply that across the other portfolios to Sunrise and Tucker, which haven't been spending capital this year. And as we go into our planned program next year, we see basically applying those FCCL processes to leverage the same magnitude of advantage going forward.

Jon McKenzie

Yeah. It's Jon. I'll just add on to that, too. I think we see a lot of opportunities even beyond the heavy oil assets. In the conventional business, I think we've also been able to work assets like Ansell Wilrich where we've, again, applied sort of our drilling techniques to that to, I think, that benefitted the Company. And then the other thing that we've hinted at and one of the reasons that we really liked this merger was the overall integration opportunities that we have with the upstream and the downstream that we acquired.

And we still think that there is integration opportunities that we will have at Lloydminster where we acquired an upgrader and an asphalt refinery. And then remember, we're in the midst of rebuilding Superior, which is a small refinery, but it will eat the molecules that we produce here in Western Canada.

So we think there's opportunities across the portfolio to improve the operating metrics in the upstream, but longer term we also think there's integration opportunities between the upstream and the downstream that we've acquired.

Alex Pourbaix

Yeah. And it's Alex. Maybe I'd just make one comment, and I think both Jon and Norrie are probably too bashful to say this. But I was looking on our energy regulator, on Alberta's website the other day and saw that the top 15 oil wells in the province are all Cenovus wells. And that is a testament to the operating techniques and strategy that Norrie's team bring to that upstream and Drew's team on the conventional, very, very similar.

Carly Davenport

That's great. Appreciate the colour.

Alex Pourbaix

Thanks.

Operator

And we'll take our next question from Phil Gresh with J.P. Morgan.

Phil Gresh — J.P. Morgan

Yes. Hi. Good morning. Thanks for all the updates today around capital allocation. I did have one follow-up with respect to the dividend piece of the plan moving forward. Jon, just any thoughts you could share around how you think about the right framework for dividend as a percentage of the capital allocation, whether it's your focus on a breakeven or a percentage of cash flow or something like that perhaps on a longer-term basis?

Jon McKenzie

Well, I can give you my thoughts, Phil, but remember, this isn't my decision in isolation. This is something that the Board thinks about pretty regularly. But what I would say, and we had a long discussion around this at the board meeting; lots of views. Our view around the dividend is that it needs to be sustainable and paid out of free cash flow at $45. So under that scenario, this company still has lots of room to grow the dividend.

Similarly, we would be of the view that share buybacks need to happen when the share price isn't reflecting its net asset value of mid-cycle pricing. And when we looked at the shareholder returns that we wanted to implement in this quarter—and recognize this as a point in time; this isn't the definitive discussion we're going to have on shareholder returns—we felt that there was much more value to the shareholder in us buying back shares at these kinds of valuations relative to increasing the dividends even farther.

What I would also say is that at these kind of commodity prices, this company is generating $600 million to $700 million of free cash flow a month. So these discussions on how we think about shareholder returns are really going to be dependent on that framework that I talked about, as well as sort of price movements of our equity in the future.

So I think this will be plenty of room for future discussion on this, but this is where we are today. This is kind of the point in time in how we think we can maximize the return to the shareholders.

Phil Gresh

Got it. That makes a lot of sense. In terms of CapEx, as you look at 2022, do you think you can stick with the same kind of sustaining framework with maybe a little bit of growth capital in Superior? Or any inflation pressures or other things that we should be thinking about?

Jon McKenzie

Yeah. I think we've been really clear, Phil, that $2.4 billion is the right number across this asset base to sustain production in and around sort of 775,000 barrels to 800,000 barrels a day, as well as keep the downstream in that safe and stable condition. That continues to be a good run rate. And you can hold that for the foreseeable future.

We've also been pretty clear that over the last few years we have underinvested in the upstream and there is some catch-up to do. So it's not something that's, as I mentioned before, a left-hand turn from where we've been, but there will be some incremental capital to catch up on some underspending that we've had in the upstream. And as you mentioned, we still have to finish Superior. And we think there'll be $200 million to $300 million more that we're going have to spend in 2022 to finish that project. But again, we believe that most of that capital will be covered off with insurance proceeds.

So when we do release the budget, Kam, I think we're in December, around December 5 of this year, you'll see a full picture. But nobody should be surprised. It'll be very consistent with what we've talked about through this year and what we've talked about since we made the acquisition of Husky.

Phil Gresh

Got it. And then just on the Superior proceeds, is there a way to think about the cadence of what has been spent versus what has been collected so far? Obviously, there will be the spend next year and the related collections for that piece, but is there any kind of additional catch-up that we need to be thinking about relative to what has already been spent?

Jeff Hart

Yeah. It's Jeff here. Yeah, there will be some catch-up. I'll just give you some colour. We brought in about US$100 million in this past quarter. I would expect us to exceed that in Q4. And so you will see at some point rateable here lagging the spend, and then I think there will be a catch-up here as we get into early part of next year with the insurance providers. But that's just kind of where we're at. And we're a few hundred million in on both the PD and the business interruption recoveries to date. And as I said, we're about $100 million this past quarter. I expect to exceed that in Q4, and then we'll have some probably catch-up into next year.

Phil Gresh

Great. Thank you for that.

Operator

Go to our next question from Dennis Fong with CIBC World Markets.

Dennis Fong — CIBC World Markets

Hi. Good morning, and thanks for taking my questions. Really appreciate the colour that you've provided around capital allocation, as well as the balance sheet. If it's possible, I'd like to switch over to the operational side a little bit more. We're obviously seeing a little bit of an energy crunch within Europe and Asia. Just wondering in terms if you could give incremental context. I know you had a small comment there on the Indonesian assets, but how are you seeing Asia Pac as a whole in terms of relative gas demand, just given, obviously, you guys garner quite strong pricing in that region and that asset generates a lot of free cash flow, so just curious as to what you guys are seeing with respect to Q4 and Q1 upcoming as well?

Jon McKenzie

Yeah. Dennis, it's Jon. And Norrie may want to chime in on this as well, but what I would remind you is that when we sell gas in Asia, whether it be with our South Asia assets just off the coast of China or

Indonesia, this is all fixed price gas, and it's all governed by contracts that have minimum and maximum DCQs. So the volume and the price are really set by the contract.

And what we've been seeing, and this should surprise nobody, I guess, is that the PRC has been maximizing the daily takes from the assets from the South China Sea, and we've had rateable takes off of Indonesia. So that's been, I think, a very good news story for us. And Alex has kind of talked about the amount of free cash flow that those assets have generated through the past nine months and where we see that going through the end of the year.

One of the things we are working on is increasing our gas sales there. So looking for, with our partner CNOOC, to increase the amount of gas sales that we can take into China, and we've made some progress on that. Nothing is imminent there, but those are things that are opportunities for us to increase our gas sales.

The other thing I would kind of remind you is that although today we're selling somewhere in between 8,000 to 10,000 barrels a day in Indonesia, we have three expansion projects underway that'll take that production up to about 20,000 to 22,000 barrels a day at the end of 2023. And those barrels, although that's a relatively small number, will generate about $250 million of free cash flow a year.

So it's a very profitable business. It isn't volatile on pricing and it's not volatile on the offtakes. It's all really governed by those gas contracts in South China.

Norrie Ramsay

I would just add, Dennis, our gas is rich, so it has high liquid content. And we're actually seeing very, very strong Brent-plus prices as we do our liquid liftings as well. So across that whole portfolio, gas and liquids, we're kind of maximizing as much as we can contractually do at the moment. And we see that going forward for the rest of the year.

Dennis Fong

Great. Great. I appreciate that colour. And then further, my second question here is also shifting over to more of the ESG side. You've outlined a couple carbon capture projects that you're participating in within the Lloyd region, as well as further kind of work on a solvent pilot at Foster Creek. I was just curious if we can get a quick update on that side as well as any of the, we'll call it, key items or takeaways that you're looking for from those various pilots or initial projects, both at Pikes Peak and the Lloyd ethanol plant?

Alex Pourbaix

Sure. Happy to do that, Dennis. I think what I might do, Rhona DelFrari is here, and Rhona's our Chief Sustainability Officer. And this is probably a good time to introduce her on our call.

But, Rhona, why don't you take that?

Rhona DelFrari — Senior Vice-President and Chief Sustainability Officer, Cenovus Energy Inc.

Hi, Dennis. Thanks for your interest in that. So right now we plan to come out with our revised ESG targets along with our Investor Day in December. And part of that will be some examples of how we expect to achieve them, both in near term and then our longer-term ambition to get to net zero.

This work is also connected to the Oil Sands Pathways to Net Zero initiative that we're part of along with, we just announced ConocoPhillips Canada joined today, so along with five of our other oil sands peers.

And so those projects in particular that you're mentioning, some are at different stages. So some are at the feasibility stage that we're looking at, and then there's projects to reduce our emissions, such as what we're doing to reduce methane in the conventional area that are already well underway. And so there are many pathways, as the name of the broader initiatives suggests, for how we're going to achieve these targets.

A lot of them are the bigger projects, such as larger carbon capture and storage that we're looking at for our oil sands assets. We're meeting to decide whether that is something that we are going to pursue, but right now we're working closely across our organization, but with the operations groups, as well as with the technology development groups to look at different ideas. And really we see that there are many different solutions that we can pursue.

We're working closely with the federal and provincial governments right now because as they've made really strict commitments to achieve their Paris goals, they've talked about how they need to work with industry on things like tax incentive, grants to really encourage some of these early stage technologies that really need a lot of collaboration with the cleantech industry, with government, with industry, and with others to get them off the ground. So those projects that you talked about and you mentioned in particular we'll provide a bit more colour on some of them when we get to Investor Day.

Dennis Fong

Okay. Great. It sounds like I have to hold tight for the details then. Appreciate it. Thank you for taking my questions.

Alex Pourbaix

Thanks, Dennis.

Operator

And we'll take our next question from Matt Murphy with Tudor, Pickering, Holt.

Matt Murphy — Tudor, Pickering, Holt

Hi. Thanks, and good morning. Just on the operations side, was wondering if you could comment on how we should think about the path forward for Foster Creek; I guess just thinking primarily on the new pads that came on that appear to be running at, I think, record rates. I guess the question is, should we anticipate these falling to lower plateau rates? Or would you characterize them as already in that kind of standard sort of SAGD plateau rate in the curve?

Norrie Ramsay

Yeah. It's Norrie here. Yeah. We're very pleased with the strong production we're getting from our west arm. There's been three pads being brought on. I mean, just for a bit of scale, W34, one of the pads is doing steadily for the last 60 days about 40,000 barrels a day and another one, W35, 20,000 barrels a day. Very strong production.

We're benefitting very, very deep pay, very clean pay, and very high ops availability in our plant at the moment. We actually have, if you like to think of it this way, we have about three pads a year that we bring on and we augment it with redrills and redevelopment opportunities. So we basically see a path forward to sustaining strong production for the remainder of the year. And then into next year, at Investor Day we'll kind of like give you an update of the range then.

Matt Murphy

Okay. Great. And just to follow up just at Liwan, maybe following up there. I was wondering if you could remind us on how we should think about the pricing mechanism for, I think, the legacy Liwan going forward, not the 29–1 component of sales? I think going back a year or more, there was some concern that it might get re-priced lower, but we're obviously in a bit of a different global gas market today. Thanks.

Norrie Ramsay

Yeah. And we have a mechanism where just now we're overlifting above at 120 percent and it goes back to the contract amounts mid next year. So the actual rates are based, obviously, on the market gas and oil prices in China.

So we're still working within those kinds of confines, but production basically goes from this 120 percent lifting to 85 percent lifting next year. And as Jon mentioned, we're actually looking at potential alternative commercial models to actually help sustain gas production at a high level going forward.

Jon McKenzie

Yeah. Matt, it's Jon. If you're actually looking for the mechanisms on the three producing areas, as well as Indonesia, why don't you give IR a call and they can kind of walk you through that?

If you look at the quarter, though, on a blended basis—and it's because, as Norrie mentioned, they're overlifting relative to the normal DCQ—the blended price in China was about $12 for the quarter. But there's a few puts and takes in there. And then you've got to remember that we have different working interests in 29–1 relative to 3–1 and 34–2.

But IR can kind of walk you through kind of the sliding scale, as well as the difference in pricing as it relates to the layers of offtake that CNOOC is entitled to.

Matt Murphy

Okay. Great. Thank you.

Operator

We'll go to our next question from Manoj Gupta with Credit Suisse.

Manoj Gupta — Credit Suisse

Hey, guys. Congrats on re-instigating the buyback. I'm just wondering if, is there a way any kind of agreement can be worked out where the shares that Conoco has, which they own, can be traded in a block to you directly so they don't come to the market and then you have to buy them? I mean, is this something possible or something could be worked out on that direction?

Jeff Hart

Yeah. I'm an avid—it's Jeff here. I think this process we kind of view the NCIB as is, obviously, through that execution more open-market purchases. And I think that provides us flexibility in execution.

I think Conoco has been looking at the public disclosures fairly rateable in how they've been winding down their position. I think through the NCIB we have flexibility to the open market and we feel that will provide the support to the share price and really balance out in the market. But I think we feel this is the best mechanism we have now and provides us flexibility and execution versus a direct block purchase.

Alex Pourbaix

And, Manoj, it's Alex. And just to kind of, if anyone missed that, I mean, if you look at the scale of the NCIB that we announced, we're always talking to Conoco and we're always trying to see if there's an opportunity. But I would say that we're pretty confident that even in the event there isn't an opportunity to do one of those big block trades, with the size of the NCIB that we're contemplating, we believe that we can more than offset any of the pressure that's coming on the stock through the Conoco sort of rateable sell down.

Manoj Gupta

That's perfectly clear. And my follow-up quickly is on the carbon capture and sequestration, and you kind of mentioned some of the things that there will have to be a collaboration between you and the government and stuff. And I'm just trying to understand from the perspective of Cenovus or the consortium, any idea of what kind of partnership or support the government could provide, whether they could chip in with some of the CapEx? Whether they could give you more in terms of carbon credits, set a price? Anything on that direction? What kind of help would the consortium be looking from the government to take this thing and make it work?

Alex Pourbaix

Yes. I'm happy to take a cut at that, Manoj. And Rhona may jump in. But I mean, you would have seen probably about three or four months ago the federal government announced a process with respect to setting up a tax credit for people investing in carbon capture and sequestration. And that's a process. There's a consultation process that's been going on for quite some time.

I think there's many, many ways that governments can be of help and that we can collaborate with governments. And you've seen that. You see that in Norway; you see it in U.S., governments using tax policy to make it easier for new entrants in this kind of technology.

So I think that, to me, is the most obvious first step on our collaboration with the government. And I think that consultation is going pretty well, but maybe I'll turn it over to Rhona.

Rhona DelFrari

Yeah. No, we're having excellent talks with all layers of government on this. And again, it's a shared goal that we have. It's Canada's goal to get to net zero, and it's our industry's goal and Cenovus's goal to get to net zero by 2050. And so it only makes sense that we're working closely together.

And what we're talking to them about is the tax credit in particular, or the investment tax credit that has been announced already, is for CCUS. It's very specific. And that will be, we expect, a large part of how it makes these CCUS projects' economics to be able to proceed because, again, CCS works. We know that CCS works. It's been proven many times. But at the scale that we're talking about, it's never been done before.

And so there are some risks associated with that. And anytime that you're in any industry, when you're going forward with something that's at early stages, you have to de-risk that. And part of that is when government steps in to encourage these technologies that are for the benefit of all Canadians, but also that the industry can progress.

And the other things that we're talking to the government about is really multi-departmental. And so there's certain opportunities through programs to encourage technology development in Natural Resources Department, in the Environment, Climate Change Canada Department. Even the Canadian Infrastructure Bank has some opportunities. And so government departments when we talk to them, we're not just talking to one ministry or department, we're talking to multiple departments. And they're working with us to say these are the types of initiatives that we can provide to you to support and really grow this cleantech industry in Canada working along with the oil and gas sector so that we have both a thriving oil and gas sector that's low cost and low carbon, but also a thriving cleantech sector that is feeding into the oil and gas sector some of these technologies that can then be exported around the world.

So lots of opportunities that the government acknowledges and that our industry does as well.

Manoj Gupta

Thank you for taking my questions.

Alex Pourbaix

Thanks, Manoj.

Operator

We'll go to our next question from Harry Mateer with Barclays.

Harry Mateer — Barclays

Hi. Good morning. One follow-up I have on the balance sheet is that you made the rationale for the refinancing transaction very clear in terms of pushing out and de-risking the maturity calendar. But I guess thinking through it, doing that has a bit of a cost in terms of shrinking the available pool of shorter-term debt that can be cheaply paid down in advance and rating agencies do vary in approach. But generally, gross debt tends to be viewed as a little bit more important than net debt. So if you want to get to mid-BBB, how should we think about you guys converting net debt reduction into gross debt reduction in the next year or so?

Jeff Hart

Yeah. It's Jeff here. I mean, I think if you—I'll use Q3 as a colour. I mean, we'll be balanced in approach. There was opportunities, I think, in the market to effectively refinance, de-risk the front end. And obviously, I think we'll continue to look at different opportunities to attack the gross debt here over time.

And look, the market moves and I think we're seeing upward movements on interest rates, but we'll be balanced in that. And I think we'll continue to focus on more at the front end. But again, it's market dependent, and I think over the next little bit you could probably see us hold a little bit more cash than we have, that we say our floor is of $1 billion. But look, I think we saw an opportunity in the market to de-risk, take care of the front at an effective cost, save over $40 million annually in interest, and as the market presents itself, we'll be judicious and take those opportunities on the gross debt.

So, expect us to balance all of that, both the maturities, the liquidity, and then the gross deleveraging. And I think we've worked through and obviously have very good relationships with the rating agencies as well.

Harry Mateer

Okay. Thanks for that. And then switching gears a bit, I'm just wondering if you have any colour on the recent widening and the WCS diff in the past few weeks. What might be driving that? It's not necessarily what we would have expected after L3R started line fill, but I know it also had narrowed into that event. So just curious. You have perspective there?

Keith Chiasson — Executive Vice-President, Downstream, Cenovus Energy Inc.

Yeah, Harry. It's Keith here. And I think it's a bit of two stories. We're seeing a bit of widening on the heavy barrel down in the U.S. Gulf Coast. There's some refinery turnarounds that are happening in the Gulf Coast that are kind of pushing that a little wider. Also, I think with kind of natural gas prices globally, it's causing some refiners to choose to try to run a little leaner and reduce kind of their operating costs and not process as many heavy barrels.

When you back up to Alberta, obviously, inventories are running high, and we're seeing some increased production. Right here at Cenovus, we're hitting some records. So that's kind of putting a little pressure. We're into the winter blend season. So condensate usage is up. And so you couple that with Line 3 coming on and taking additional egress out and kind of rail running at minimum kind of baseline rates, we're kind of seeing the differential normalize around that $15, $16 but a lot of it's because of what's going on down in the Gulf Coast.

Harry Mateer

Great. That's helpful. Thank you.

Operator

Once again, as a reminder, join the queue to ask a question by pressing *, 1. Again, that is *, 1, for questions.

There are no further questions at this time. Mr. Pourbaix, I'll turn the call back to you for any additional or closing remarks.

Alex Pourbaix

Thanks very much, and thanks, everybody, for your continued interest in the Company. And with that, we'll sign off and let everyone get back to their day.

Take care.

Operator

That concludes today's call. Thank you for your participation. You may now disconnect.