Cenovus Energy, Inc.

Cenovus Energy, Inc. Q2 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 Second 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 star, one. 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 express consent of Cenovus Energy.

I would now like to turn the conference call over to Mr. Patrick Read, Vice President, Investor Relations.

Please go ahead, Mr. Read.

Patrick Read – Vice-President, Investor Relations, Cenovus Energy

Thank you, Operator.

Good morning, everyone, and welcome to Cenovus' 2024 second quarter results conference call.

On the call this morning, our CEO, Jon McKenzie, will take you through our results. Then we'll open the line for Jon and other members of the Cenovus Management team to take your questions.

Before getting started, I'll refer you to our 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. They also outline the risk factors and assumptions relevant to this discussion. Additional information is available in Cenovus's annual MD&A and our most recent AIF and Form 40-F.

As a reminder, all figures we reference on the call today will be in Canadian dollars unless otherwise indicated. You can view our results at cenovus.com.

For the question-and-answer portion of the call, please keep to one question with a maximum of one follow-up. You're welcome to rejoin the queue for any other follow-up questions you may have.

We also ask that you hold off on any detailed modeling questions. You can follow up on those directly with our Investor Relations team after the call.

I will now turn the call over to Jon. Jon, please go ahead.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Great, and thank you, Patrick. Good morning, everybody.

I'm going to start this call by highlighting some safety achievements in our second quarter. We completed the largest turnaround in the history of the Lloydminster Upgrader. The turnaround was completed with approximately one million man-hours and peak mobilized workforce of about 3,200 contractors. This was no small feat. What I'm most impressed about was our safety performance.

Our planned 49-day turnaround was done with no incidents, and I want to acknowledge all of our staff and contractors for their incredible commitment to the safety and success of this turnaround.

We've also seen a number of wildfires recently across northern Alberta and in some cases in close proximity to our Oil Sands sites. We are prioritizing the safety of people working on the site and are closely monitoring the evolving situations. While we had limited our staff at Sunrise asset for a short period of time, with the recent rainfall and firefighting efforts, we're in a better place. We have now returned all our staff to Sunrise site, and all of our assets continue to operate at normal rates.

Today marks a significant milestone for Cenovus and our shareholders. In the month of July, we achieved our net debt target of CAD $4 billion, and we are now moving to returning 100 percent of excess free funds flow to shareholders as per our framework.

I'm very proud that we'll be delivering a substantial increase in shareholder returns going forward. While this Company has been on a deleveraging journey for a number of years, achieving the target is a direct result of our financial discipline and resilience. It really sets the stage for continued growth in our shareholder returns over time.

Our second quarter results are underpinned by the strength of our operating performance and continued focus on controlling costs, and our ability to deliver on our plans and drive value for shareholders. Our upstream business continued to deliver very strong operating results with production of over 800,000 BOE per day in line with the prior quarter.

Production for the first half of 2024 continues to trend at the higher end of our guidance range. In particular, the operating performance at our Oil Sands assets continued to be exceptional in the second quarter. This was achieved while completing some initial work scope on the Christina Lake turnaround and taking a short outage at Sunrise in May for well pad tie-ins.

In the second quarter, Oil Sands produced around 610,000 barrels a day and generated an operating margin of approximately CAD $2.7 billion, an increase of over CAD $500 million from the prior quarter.

Looking to the third quarter, we're ready to execute the turnaround of Christina Lake beginning in September. The turnaround is anticipated to reduce third quarter production by about 45,000 barrels a day.

We also remain on track with our execution of Oil Sands growth projects. This includes the Narrows Lake tie-back to Christina Lake, which continues to track on schedule. The pipeline is now 88 percent constructed, with first segment hydro-tested and mechanical completion expected to be finished by the end of the year.

We've also completed the drilling of the first two well pads at Narrows Lake Resource Area, and we're on schedule to deliver first oil in mid-2025.

In addition, the Foster Creek Optimization Project remains on schedule for our targeted 2026 startup, with most modules and major pieces of equipment in place and piping installation well underway.

At Sunrise, the first of four new well packages is nearly complete. Within the first well package, we've ramped up one well pad, and we're expecting to bring on two new well pads later this year, and the fourth in early 2025.

The remaining three well packages continue to progress as per schedule. In our conventional gas business, production volumes were around 123,000 BOE per day, an increase of 2,400 BOE per day relative to the prior quarter. Our conventional business also reduced per barrel operating costs, primarily as a result of focused efforts to improve the cost efficiency of the business.

In our offshore business segment, production was approximately 66,000 BOE per day, an increase of 1,300 BOE per day compared with the prior quarter. In Asia, the operating margin was CAD $264 million, and we continue to see the benefit from strong regional gas demand.

In the Atlantic region, production from the non-operated Terra Nova asset increased by about 1,200 barrels per day relative to the prior quarter, and the operator continues to work towards ramping up towards full rates.

Now, the Sea Rose FPSO is currently at dry dock for its regulatory maintenance. This work is progressing well, and we are fast approaching project completion. We expect the Sea Rose to return to the field late in the third quarter of this year and resume production in the fourth quarter.

We also achieved a significant milestone for the West White Rose project in the second quarter, with the concrete gravity structure reaching its final height and structural completion of the topsides. The

West White Rose project is now 80 percent complete and remains on track for first oil in 2026.

With our upstream businesses continuing to produce at the higher end of our guidance range, we've updated our full year upstream production guidance. We've increased the lower end of the range by 15,000 BOE per day for an overall upstream guidance range of 785,000 to 810,000 BOE per day.

I'm very pleased with the performance we've seen year-to-date and remain confident in executing the work that remains ahead of us for 2024. We expect to be exiting this year well above 800,000 BOE per day following the Christina Lake turnaround.

In addition to increasing our production guidance for the year, we've also reduced our operating cost guidance in several of our business segments based on year-to-date performance and our continued focus on cost leadership across this company.

The guidance for capital spend of CAD $4.5 billion to $5 billion remains unchanged, with planned spend for our growth and optimization projects ramping up slightly in the second half of the year.

Now moving to our downstream segment. In the second quarter, Canadian refining results were impacted by the planned turnaround at the Lloydminster Upgrader. As I mentioned earlier, safety and operational execution of the turnaround was outstanding amidst some of the weather-related delays that impacted productivity and schedule by about a week and elevated the overall cost.

The Upgrader has since completed its ramp up to normal rates and is operating steadily. In addition to regulatory and maintenance work undertaken during the turnaround, we also implemented seven large projects at around CAD $50 million of capital spend that enable us to further enhance reliability at the asset, including advancing automation of our systems.

In the U.S. refining segment, combined crude utilization across the assets was about 93 percent in the second quarter. We have made some progress on reliability and there is more work to do. We are continuing to focus on the reliability, cost structure, and profitability of the downstream business going forward.

In our U.S. refining businesses, the narrower light-heavy differential combined with some planned and unplanned outages impacted operating margin in the quarter.

The continued focus on driving value in our downstream business has led the Company to optimize planned turnaround activity in the second half of the year. During the Lima turnaround this fall, we will be leveraging the integration of Lima and Toledo to minimize crude unit downtime. Additionally, some planned` maintenance has been deferred to 2025.

Now as a result of the performance in the U.S. refining business year-to-date and the optimization of the turnaround activity going forward, we have updated our full year downstream throughput guidance to 640,000 to 670,000 barrels a day. This is an increase of about 10,000 barrels a day to the lower end of the range.

Now to our corporate and financial performance. Cenovus generated CAD $2.9 billion of operating margin in the second quarter, approximately CAD $2.4 billion of adjusted funds flow, and CAD $1.2 billion of free funds flow, which reflects higher benchmark crude oil prices and a narrowing light-heavy differential.

Through our base dividend, share buyback program, and variable dividend, we paid over CAD $1 billion in shareholder returns. At the end of the second quarter, net debt was approximately CAD $4.26 billion. As I mentioned, in the month of July, we achieved our CAD $4 billion net debt target.

This is a significant milestone, and overall, this has been another strong quarter for the company. We have a clear view of the work in front of us, and we're looking forward to delivering on the growth projects we've set out to accomplish and increase production guidance for the 2024 that we shared with you today.

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

Q & A

Operator

Thank you.

Ladies and gentlemen, as a reminder, you can join the queue to ask a question by pressing star, one. We will now begin the question-and-answer session and go to the first caller.

Your first question comes from Neil Mehta from Goldman Sachs. Please go ahead.

Neil Mehta – Analyst, Goldman Sachs

Yes. Thank you so much, and congratulations on achieving the net debt target here in July, Jon and team. The first question is actually around West White Rose. It's an unbelievably important project as we think about the free cash flow progression. Can you just talk about what are the gating items here and as we move towards topside in 2025?

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Sure. Maybe I'll start, and then I'll let Keith chime in on this. You're absolutely right. Hitting the CAD $4 billion net debt target has been something this organization has been really focused on for a number of years, and it's a great day for this company and a great day for our shareholders. I think as it relates to West White Rose, we mentioned that we're about 80 percent complete, but we've really largely completed the work on the gravity-based structure and the topside, and we now move really into the marine-based part of the project. Maybe Keith, you can talk in a little bit more detail about where we are with that project.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Yes. Thanks a lot, Neil. The way you should think about the project, it's broken down into really four components. One is the Sea Rose asset life extension project. The Sea Rose is over in dry dock, approaching completion of that maintenance activity, and will be coming back on station at the back end of the third quarter to restart production early in the fourth quarter so that's progressing well. That allows us to extend the life of the asset out into the late 2030s. On the West White Rose project, per se, we were actually able to visit the gravity-based structure last week, and I'd like to say that things are extremely progressing well, nearing, as Jon alluded to, mechanical completion there. They're getting ready to flood the graving dock, which will allow us to tow the gravity-based structure out and set it up with the topsides. Down in Ingleside, similar story. The topsides are approaching mechanical completion, into commissioning already, and it'll be ready to tow out in the second quarter of 2025. A lot of marine work is now progressing, which will allow us then to connect the West White Rose project to the Sea Rose. All that activity is on track for summer 2025, and then we'll be able to commence drilling at the back end of 2025 and start seeing production and the ramp-up in production in '26 and '27. Things, Neil, are progressing really well. Still a bit of scope ahead of us. We're spending about CAD $700 million to CAD $800 million this year and CAD $700 million to CAD $800 million next year to finish the project, and then we, as you alluded to, go into the cash flow stage of receiving cash as we go into production in 2026.

Neil Mehta – Analyst, Goldman Sachs

All right. Thank you. The follow-up is just on Canadian refining performance this quarter. U.S. manufacturing inflected operationally, but it was a little bit of a tougher quarter in Canadian refining. Can you remind us the environment up there and how much of that was one-time in nature, and how do you see that part of the business progressing from here?

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Yes. In Canadian manufacturing, we had the Upgrader down first week in May for its 49-day turnaround. That extended into the first week of July. The major asset in Canadian refining wasn't operating. It was down for turnaround during the quarter. Now, also remember that we expense all of our turnaround costs, and I think we expensed about CAD $211 million to CAD $220 million during the quarter. All of that is one time. We have a turnaround schedule with that Upgrader once every four years. This was, as I mentioned, the largest that we had done. It's more of a reflection of the turnaround than it is the operating performance of the Canadian downstream.

Neil Mehta – Analyst, Goldman Sachs

Thanks, Jon.

Operator

Your next question comes from Greg Pardy from RBC. Please go ahead.

Greg Pardy – Analyst, RBC Capital Markets

Yes. Thanks. Good morning. Thanks, Jon, for the detailed rundown, as always. I've got a couple of questions, but the first one is maybe just a little more at the macro level. You're a large shipper on Trans Mountain. I'm interested in just your perspective on the performance of that, how you're thinking about marketing, but also related to this is, how should we perhaps see the path of WCS spreads over the next few months?

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

I'll tell you, Greg, I could answer that question, but Geoff Murray lives and breathes that every day, so maybe I'll just turn it over to Geoff to answer.

Greg Pardy – Analyst, RBC Capital Markets

Thanks.

Geoff Murray – Executive Vice-President, Commercial, Cenovus Energy

Thanks, Greg. I think the important thing around Trans Mountain is we've seen the facility come on. It's up, it's operating, and it's operating well. We've then provided relatively exciting access to the globe, and that's had its impact back into Alberta, and we've seen the heavy differential in Alberta tighten. If you compare Q1 to Q2, that's in the order of $6 US better. We can't obviously attribute all of that to any one thing because markets are a little more exciting and interesting than that. However, I would say we've seen Trans Mountain have the impact that when we took the contract, we were looking for it to deliver.

As of late, perhaps in months after Q2 has ended, we've seen the heavy differential in Alberta move out a little bit wider by $1 or $2, and many questions have come our way regarding what's going on with Trans Mountain on why is that happening. I would direct you to look at the U.S. Gulf Coast, which really is where prices are originally set, and we've seen that to be a little bit wider by $1 or $2, which we've attributed to refinery outages in the area as well as in the mid-continent. Over the next little while, I would say we expect Trans Mountain to continue to have its intended impact in Alberta and differentials to be as narrow as they've been in a long time.

Operator

Thank you. As a reminder for our analysts, you can join the queue to ask a question by pressing star one. Your next question comes from Dennis Fong from CIBC World Market. Please go ahead.

Dennis Fong – Analyst, CIBC Capital Markets

Hi, good morning, and thanks for taking my question. The first one—and also congratulations on achieving the CAD $4 billion net debt floor. My first question, there have been some news reports on some operational hiccups with some of your U.S. refineries, namely Lima and Toledo, and I also appreciate the comments that you made in the prepared remarks around progress being made around improving profitability of the operations. My question here is, can you comment on the current operations of the U.S. refineries, as well as discuss some specific projects that are ongoing and when you think some of these best practices, improving margins, and so forth, can potentially bear fruit.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Hey, Dennis. It's Keith. Thanks for the question. Maybe I'll get to your specific question in a minute, but I just want to reflect on a little bit of the progress that is being made. In 2023 was a lot of work on restarting the Superior Refinery and the Toledo Refinery and driving improvement across the fleet to improve crude utilizations. We're starting to see some of that bear fruit as we head into 2024 with higher utilizations, but by no means are we done. There's still lots of work we have available to us to improve reliability, to improve profitability, and to drive down our costs. Interestingly, sometimes it takes a turnaround to be able to drive those reliability improvements. We do have the Lima turnaround coming up here in the fall, which will allow us to advance some additional reliability improvement as we progress down this journey.

Specifically today on Toledo and Lima, both went through a couple of process upsets, which brought the refineries down into a controlled manner. Some work is progressing as we speak on maintenance. That should be wrapping up in the next day or two, and we'll be progressing with restarts of both those refineries.

Then maybe to the back end of your question, just specifically, we are seeing some of those reliability initiatives bear fruit. Jon just talked about the Lloyd Upgrader turnaround. That's another opportunity for us to go in there and reduce the bad actors that we had at the Upgrader to help drive that longer-term reliability improvement that we expect. There's lots of work underway, but by no means are we declaring victory. There's still room to improve and room to go on all aspects, reliability, profitability, and our operating costs.

Dennis Fong – Analyst, CIBC Capital Markets

Great, thanks. Appreciate that color there, Keith. Shifting gears for my second question, your thermal heavy oil assets have, frankly, not only remained resilient, but also shown growth over the past few years. Can you talk towards the work that you've been focused on there to help bolster production without any incremental steam generation capacity? Also, what do you view as the inventory or the ability to maintain that either flat or even higher over the next few years? Thanks.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Yes. Thanks, Dennis. We're really happy with the progress we're making, obviously, in our Oil Sands business and the resiliency of it and the continuous improvement demonstrated across that business. Some things I would point to, obviously, after taking over the Lloyd thermal assets and the Sunrise assets, we were able to deploy some of the Cenovus technology into those assets and immediately improve production. We do execute resource delineation and happy to report that we're finding additional resource to maintain those levels of production out into the future. Lots of activity going on and assessing where it is and making sure that we can continue to produce.

I think the other thing is obviously our NCG, so non-compressible gas, into the reservoir and timing of that. It's really, for us, a steam-oil ratio game. The more we can drive down our steam-oil ratio, the more production we can achieve. You're seeing some of those improvements across the various assets. Then maybe I'd point to Sunrise. When we took over Sunrise, it hadn't had a pad drilled and tied in since the early 2020s. We've since added three pads. They're now in the progress of either operating or ramping up. Obviously, we're deploying some of the new technologies in those pads, but also, we're starting to utilize the spare steam capacity that we had at that asset. We're pretty excited about the growth profile that we have at Sunrise over the coming couple of years as we continue to add pads and grow.

Maybe I'll just touch on some of the other growth that we have in the Oil Sands portfolio. On Narrows, we're approaching mechanical completion at the end of this year, and we will start steaming. The pads are drilled and in place, so we'll be able to progress that steaming in the first half of 2025 to see production coming out of Narrows in 2026 and remind people that that's going to be about 20,000 to 25,000 barrels a day increase. On Foster Creek, we have an optimization project underway, which is essentially a steam addition project. That project's progressing well, on track for completion at the back end of 2025, early 2026, which will then allow us to steam new pads and bring on an additional 30,000 barrels a day at Foster. Lots of exciting things happening across the Oil Sands, and it just demonstrates the continuous improvement that's happening every day in that business to make it better.

Dennis Fong – Analyst, CIBC Capital Markets

Great. Really appreciate all of that context there, Keith. I can turn it back now.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Great. Thanks, Dennis.

Operator

Your next question comes from Menno Hulshof from TD Cohen. Please go ahead.

Menno Hulshof – Analyst, TD Cowen

Thanks, and good morning, everyone. I'll start with a question on the positive OpEx guidance revisions for the Oil Sands and Asia Pac in particular. My understanding is that some of the Oil Sands improvement is probably lower fuel costs and maybe even slightly higher volumes. Beyond that, can you just elaborate on what's driving those improvements?

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Yes. I think, Menno, you hit on the two really big things in that we're working on both the numerator and the denominator of that ratio. Keith had outlined that we are seeing better production right across the portfolio than we would have had in our internal budgets, and a lot of that is related to the activities that we're taking on with the re-devs and redrills and seeing the productivity from non-condensable gas and the like so first and foremost, it's a production story.

Secondly, we are seeing improvements in our cost for energy and our use of energy. Those continue to be areas of focus for us. Managing that cost, and obviously a lot of that is commodity price driven, but also managing energy use is something that we're constantly looking at. Things like chemicals, people, and those kind of things that make up operating costs or other areas that we are constantly managing. It gets back to what Keith talked about. It's just having that mindset of continuous improvement and being dogged on going after these things on a day-to-day basis. That's what we're seeing really right across the portfolio and seeing some success not just in the Oil Sands, but also in the deep basin and our conventional assets and in refining as well.

Menno Hulshof – Analyst, TD Cowen

Thanks for that, Jon. My second question is on the upcoming Lima turnaround. You mentioned that it's been optimized and you plan to leverage the expanded refinery network. Can you maybe just elaborate on what's getting done there? The follow-on to that is somewhat related. What was the rationale for pushing out some of the downstream turnaround work to 2025? Thank you.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Hey, Menno. It's Keith. Yes. Since we've taken over Toledo and operate Toledo, we're continuously looking for optimizations between Lima and Toledo. The team came up with a really unique way to continue running Lima through the turnaround and using some of the facilities at Toledo to process the intermediate barrels that would have been put in the storage or would have drove us to reduce rate at Lima. It's a really unique optimization that's happening, and it's enabled by the fact that we now own and operate both refineries and that there's interconnecting pipe between the refineries. That will allow us to optimize that turnaround.

On the delayed turnaround, we were able to do some maintenance and inspection activity that allowed us to understand that the turnaround that we had planned at one of our joint venture operations was enabled to be pushed out. We're seeing that push out into the 2025 timeframe. All in all, that's the optimization that's happening in the U.S. downstream and why we're able to raise the bottom end of our guidance on throughput for the year.

Menno Hulshof – Analyst, TD Cowen

Appreciate the thoughts, Keith. I'll turn it back.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Thanks, Menno.

Operator

Once again, as a reminder for analysts. You can join the queue to ask a question by pressing star, one. Your next question comes from John Royall from J.P. Morgan. Please go ahead.

John Royall – Analyst, J.P. Morgan

Hi, good morning. Thanks for taking my question. Great to hear that you've hit the 100 percent here with returns of capital. Can you just talk a little bit about the mechanical approach to the buyback from here? Will you forecast the full year's cash flows and try to take a more rateable approach and correct as you go? Or should we expect it to be a little bit more variable quarter-to-quarter, depending on the actual cash flows in that quarter?

Kam Sandhar – Executive Vice-President and Chief Financial Officer, Cenovus Energy

Morning, John. It's Kam. A couple of things I would highlight there. I think number one, we've obviously been on this net debt journey reduction for quite a while, and we're there now. I think one of the first things that's really important is that we want to make sure we stay as close to that CAD $4 billion as possible as we go forward and looking at how we return cash to shareholders. That's the first thing you should think about.

Secondly, I would say clearly now that the debt reduction is behind us, there will be no more cash directed towards further deleveraging, and so all of our cash will go towards returning cash back to shareholders, most likely in the form of buybacks. I think given where the share price is today and what we see as intrinsic value, that is what people should expect, that 100 percent of that excess free cash will probably be returned in the form of share repurchases.

In terms of the mechanics, month by month, quarter by quarter, I think the thing to watch is we will be making sure that we are allocating as close to 100 percent as possible. Obviously, things like working capital movements will move our debt around, but that's something we'll be watching month by month. I think the goal is to stay as close to that 100 percent as possible while trying to hold the debt at that CAD $4 billion level.

John Royall – Analyst, J.P. Morgan

Great. Thanks, Kam. My follow-up is a macro-type question that I don't think has been asked yet. Can you talk about the supply-demand fundamentals and refining in the mid-Con right now? We've had what's looked like a tighter market than some other regions in the U.S., but certainly, also appears to have been impacted by the unclaimed downtime at Joliet. What are your expectations for the mid-Con market in the second half, particularly with Joliet coming back now?

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Thanks, John. It's a great question. Maybe start at the top and work more regionally from there. From a more macro perspective, what we've seen is very similar circumstances as recent years. That percolates through into both gas crack and diesel crack. It isn't any meaningful change on a macro perspective. As of late regionally, we've seen a regular strong summer gasoline season but what we have seen is some volatility, and it's all been supply-driven, as you pointed out. That has resulted in temporal really big moves in the price. I think for the region, which has become relatively balanced to occasionally a little bit long, we're going to see these periods of volatility as supply moves around, particularly given that demand is just persisting, it's where it's been. The story on a minute-by-minute, week-by-week basis is going to be all supply-driven.

Looking out over the next months, you can't predict what unplanned outages are going to be. They will come as they come. However, the thing that we do know is that we head into fall turnaround season and that's going to match sort of through the period of time where we switch from gasoline season to diesel season, distillate. We anticipate that that turnaround will be normal-type levels, and if there is any supply-demand imbalances, it'll tighten it up. We could probably see a little bit more of a narrow, tighter supply-demand balance through that period of time.

John Royall – Analyst, J.P. Morgan

Thank you.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Great. Thanks, John.

Operator

Your next question comes from Manav Gupta from UBS. Please go ahead.

Manav Gupta – Analyst, UBS

Hi, guys. Quick question, a little bit of a follow-up on John Royall's. It's very clear surplus cash is all going to go to shareholders, no nothing for debt reduction. Just trying to understand a preference between buyback and variable dividend. Should we continue to see a combination of those or do you have a very strong preference for one of those? Definitely buyback over variable, but if you could talk about that.

Kam Sandhar – Executive Vice-President and Chief Financial Officer, Cenovus Energy

Yes. Good morning, Manav. I alluded to this when I answered John's question. I think, number one, the principles around how we return cash, none of that has changed. You're going to continue to see us rateably, predictably grow the base dividend over time. We've typically done that in that April-May time frame, obviously driven by the board discretion. As the business grows, you're going to continue to see us target, let's say, double-digit growth in the base dividend over time. That's the first thing.

I think the second is, as I said given where the share price is today and what we see as an intrinsic value in the return on acquiring our shares back, we see that as an attractive value proposition. The variable dividend we paid in May was more a function of we under allocated our shareholder returns in the first quarter. That's not a reflection, I would say, the value that we see in the buyback. Going forward, to the extent that you continue to see an attractive share price, which we do, you should expect most, if not all of our excess returns will be done in the form of share repurchases.

Manav Gupta – Analyst, UBS

Perfect. Just quick follow-up. You did raise the upstream volume guidance for the year. If you could just talk about the thought process behind raising it at this point of time.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Sure. Manav, what we typically do through the year is we watch our performance and tighten up the range in our guidance as we get into mid-year. What today's guidance range reflects is some really strong performance that we've had through the first six months of the year and our expectations that we have in the back half of the year. What we're trying to guide the market to is the midpoint of that range that we've put out publicly today. It really is, I think, a reflection of what we've been able to accomplish and how we see the back half of the year unfolding particularly in Q4, where coming through the Christina turnaround, we expect to have very strong Q4 performance.

Manav Gupta – Analyst, UBS

Thank you so much.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Great. Thanks, Manav.

Operator

Your next question comes from Patrick O'Rourke from ATB Market. Please go ahead.

Patrick O'Rourke – Analyst, ATB Capital Markets

Hey, good morning, guys, and congratulations on hitting the net debt target there. Just first question here, you unpacked what's going on operationally in the thermal unit. Some of our recent monthly well scrubs have turned up some pretty intriguing multilateral cold flow wells that you guys have drilled. Maybe if you could walk us through the evolution of your view on the play and the potential scope that that could have.

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Hey, Patrick. It's Keith. Yes, thanks for the question, and probably the one growth project I didn't touch on before. We're really excited about what we're seeing in show. Obviously, we have a very significant landmass basis. We have a midstream infrastructure there. Obviously, it all connects right into our Upgrader and Lloyd Refinery, so a very integrated value chain. We were a pretty active driller in 2023, saw some good results. The way we set up our program, we will do our winter program around all of the assets, and then we'll deploy the rigs over into Conventional Heavy oil. You'll see us, our drilling activity, in that basin pick up here in the back half of the year, and you'll start seeing the production growth through the back half of the year coming out of that basin. We're pretty excited because we see lots of opportunity to continue to grow that as per our investor day pack easily an additional 20,000 barrels a day of growth over the next three to five years. That's what we're focused on. We're seeing pretty good results. We're working to contain and get our costs down even further, and the netbacks at strip price are really attractive.

Patrick O'Rourke – Analyst, ATB Capital Markets

Okay, great. Maybe moving back over to the macro side, you guys touched on the weakness in heavy high TAN oil in the Gulf, and that's driven some of the performance in the WCS differential. As a physical shipper on TMX, what's a little bit less clear or transparent to us is how these heavy high TAN barrels are what the opportunity set is in pad five, and what the pricing is looking like there and the marketing opportunity. Can you maybe speak to that a little bit and the potential for some value creation there?

Geoff Murray – Executive Vice-President, Commercial, Cenovus Energy

Great. Thank you, Patrick. It's Geoff. It's a really great question. As that market continues to develop, it's quite a puzzle to be solved over time. We have found, as the facility has started up, a relatively interesting split between volume with the bulk of the volume just slightly greater than half headed towards Asia rather than pad five. We've also seen demand move back and forth between heavy high TAN and light. I would say that early days here, pad five is testing it out and trying the high TAN barrels, and that may be really high TAN or that may be lower TAN over time, and they do obviously continue to like light where they can get it. It's been an interesting start. The biggest thing, as I started with, is that this has driven the differential in Alberta in the order of dollars, and so I think we continue to see that persist. There will be movement back and forth between Asia and pad five, and that actually ends up in the rebalancing of global trade flows and the pricing difference between Aframax and VLCCs has really played into this. It's been an early days thing that started quite quickly where we have seen reverse lightering off the West Coast to find the most effective, efficient move through to Asia. I'd point in that direction as well as you look to the overall balances.

Patrick O'Rourke – Analyst, ATB Capital Markets

Okay, thank you.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Great. Thanks, Patrick.

Operator

As a reminder, for the media, you can join the queue to ask a question by pressing star, one. Your next question comes from Harry Mateer from Barclays. Please go ahead.

Harry Mateer – Analyst, Barclays

Hi, thanks. Good morning. You've talked a lot about the shareholder return angle now that you're at the CAD $4 billion net debt target, but I'm curious whether reaching that long-term goal changes anything or opens up anything for you on the strategic front in terms of priorities, whether that's upstream M&A or potential JP simplifications like you've talked about in the past.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Yes. I think, Harry, nothing really changes on the strategic front. We've had a business model that has endured through time, and we're definitely looking forward to flipping over to 100 percent shareholder returns. What we're really focused on right now is the growth projects that we've got underway and we need to deliver on those. That spending started in 2023 and is largely done by the end of 2025. That's something we're focused on.

Other areas where we're obviously focused on is continuing to build out our refining business and getting that operating the way we want it to operate and managing our cost control. As we think about what's in front of us, it's going to be good to run this business model at 100 percent shareholder returns going forward. That's really what we're focused on today is just sticking to our knitting and executing on what's in front of us versus trying to take on new challenges or modifying the strategy in some way going forward.

Harry Mateer – Analyst, Barclays

Okay, thanks. Just to follow up on the balance sheet, so you've indicated in the past that you're comfortable running cash around the CAD $3 billion level, gross debt around CAD $7 billion for the CAD $4 billion net debt. The expectation we should have that as maturities come up in the next few years, you'll just plan to refinance those in regular course and maintain that cash balance around the current level?

Kam Sandhar – Executive Vice-President and Chief Financial Officer, Cenovus Energy

Hey, Harry, it's Kam. I would say a couple things. Number one, right now, I'd say, we're in a very good position financially where we don't really have a lot of maturities coming at us here in the next little while. Our next maturity is a really small one in that CAD $150 million range in 2025, and then we're free and clear through to 2027. I think in the short term, you probably will see us just continue to put that cash on the balance sheet and that mix that you referenced around cash and gross debt. I don't envision you're going to see any material changes. Obviously as market conditions change and move, we'll always look at opportunities if they're there for refinancing, but right now, I'd say we're in a really comfortable position where the maturity profile we've got and the coupon and the tenor that we've got on our debt is quite optimal given the environment we're in.

Harry Mateer – Analyst, Barclays

Okay. Thank you.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Good. Thanks, Harry.

Operator

Your next question comes from Alex Bill from allNewfoundlandLabrador. Please go ahead.

Alex Bill – Journalist, allNewfoundlandLabrador

Hi. Sorry, I should be grouped with media questions. Good morning. On the Sea Rose turnaround, you talked about the return of production in Q4, which is the change from prior quarters when it was expected in Q3. Is that just the nature of dry docking today or are there specific delays there that you can speak to?

Keith Chiasson – Executive Vice-President and Chief Operating Officer, Cenovus Energy

Hey, Alex. Yes, no, the dry dock is going well. I would say the start to the steel replacement on the hull was a little delayed, but now it's progressing extremely well. We're anticipating on having the vessel sail out of the dry dock towards the end of August, early September, and be back on station and then the re-hookup and restart of production early into the fourth quarter. A little bit delayed, a couple of weeks to four weeks, but all in all, the work is progressing well now and as expected. We'll be back on station and restart production in the fourth quarter.

Alex Bill – Analyst, allNewfoundlandLabrador

Okay, thanks for that. As you're probably aware, Upstream reported a few weeks ago about potential sales of some of your South Asian assets. I just wondered if you could potentially speak to that. If not, taking into note you're sticking to your knitting line earlier, how you might look at other acquisition or sale opportunities as you balanced your debt where you want it now.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Yes, Alex. It's Jon. We really like our portfolio today and we're not looking—I don't know where that report came from. To be honest, I haven't seen it. We like our portfolio and we're in a position today where we are sticking to our knitting and continuing to drive efficiencies right across our business and deliver on our growth projects. I can't comment on a particular report that you've seen. I haven't seen it, but there's certainly nothing in it from our perspective.

Alex Bill – Journalist, allNewfoundlandLabrador

Okay, thank you.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Thanks, Alex.

Operator

Your next question comes from Emma Graney from The Globe and Mail. Please go ahead.

Emma Graney – Journalist, The Globe and Mail

Yes, good day. Thanks for taking my question. I want to ask you, in your press release there, you talk about the ESG report that was going to be coming out end of June. Obviously, a lot of uncertainty because of Bill C-59. When can we expect to see that report, and what are you hearing from the Competition Bureau there on how those rules are going to pan out?

Jeff Lawson – Senior Vice-President, Corporate Development & Acting Chief Sustainability Officer, Cenovus Energy

Hi, Emma. It's Jeff Lawson here. First of all, on the Competition Bureau, we'd like to commend the Commissioner of the Competition Bureau for acting quickly and coming out with a consultation process. I don't know if you're aware of that, but a lot of consternation around uncertainty in the wording and the legislation, which is why people have pulled back on disclosure. The Competition Bureau has launched a consultation where everyone is now proactively commenting to try to clean up the guidance around what will be presented and what won't. That consultation period is through until September. We should have all of our comments in and expect some further clarity as we go through the fall.

In terms of what will be done, we'd like to make a few points. Everything that we were doing prior to the enactment of the legislation, we continue to do. Any environmental work, emissions reduction, land reclamation, on the governance side, Indigenous reconciliation activities, just being good stewards of capital in our communities, we're absolutely continuing to do. On the social governance side, we have our report almost ready to go. We should get it out within the next month, pared back on the environmental side until the legislation is cleaned up a bit. On that front, everything we can do to figure out what an internationally recognized standard is, is something we'll continue to do alongside the Competition Bureau and the producers here. When we have further clarity, we'll come up with something, we just don't have that clarity yet.

Emma Graney – Journalist, The Globe and Mail

Okay, great. In the scale of things, how annoying is that whole C-59 thing?

Jeff Lawson – Senior Vice-President, Corporate Development & Acting Chief Sustainability Officer, Cenovus Energy

It's been a tremendous amount of distraction and work for an incredible number of people who are just trying to do the right thing. It's been a distraction, everyone, it's taken a huge amount of time and resources. What's frustrating is that I would say people in this industry, and specifically in our Company, we do want to speak to all the good things we're doing. We do want to let people know what we're doing so that's our longer-term intent and plan, and you can expect we'll approach it that way, and you get these curveballs thrown at you, and the best thing you can do is try to work through it and not get too frustrated, and, I think, work with government and work with the Bureau, and we'll come out the other side where we think it will be a decent place.

Emma Graney – Journalist, The Globe and Mail

Thanks very much.

Jeff Lawson – Senior Vice-President, Corporate Development & Acting Chief Sustainability Officer, Cenovus Energy

Thank you.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Great. Thank you so much.

Operator

Your next question comes from Chris Varcoe from Calgary Herald. Please go ahead.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Good morning, Chris.

Chris Varcoe – Analyst, Calgary Herald

Hi, Jon. With Oil Sands producers, including Cenovus, planning more production increases here in the next couple of years, how quickly do you see Western Canada getting back into a situation where the pipelines are running full again and potentially impacting differentials?

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Yes. We get that question a lot, Chris, and there's been a number of different theories. Some of the pipeline producers or pipeliners are thinking it's going to be a shorter period of time than the producers. We have an internal view. We think at some point the history of this basin is we do fill available pipeline space, but we also think we have a number of other options to move more barrels out of this province and keep the differential in check.

One thing I would say to you is I think for the big oil producers in Western Canada, we've largely solved for the differential in that we've all got either upgrading capacity or export capacity for the majority of the volumes that we export. Whether we fill up these pipelines Enbridge has said a couple years or whether it takes five, six years, the impact to our business models is less than it used to be five, ten years ago. I don't have a firm number for you, Chris, other than at some point we will fill these lines. The impact of the business model and other options we've got for egress, I think, are there today.

Chris Varcoe – Journalist, Calgary Herald

Just following up on TMX, you talked about the fact that it's going to have an impact upon the industry and upon Alberta. I guess what are you seeing is not just the immediate impacts but the longer-term impacts, and ultimately, do you think it's going to be worthwhile or worth it for Canadian taxpayers who obviously put a lot of money into a project which is run well over budget?

Kam Sandhar – Executive Vice-President and Chief Financial Officer, Cenovus Energy

Absolutely, Chris. The construction and commissioning and running of the TMX pipeline is a great day for Canadians. Admittedly, it was over budget and admittedly, it was probably more expensive than it needed to be. That being said, this will generate a huge amount of revenue for Canadians in the form of royalties and tax dollars that go towards the public purse, and in my view, increase the standard of living for all Canadians. Short, medium, and long term, this is a great asset for Canada and it's an important piece of infrastructure for the country.

Chris Varcoe – Journalist, Calgary Herald

Finally, I just want to follow up on a question that Emma asked, and that's regarding Bill C-58. There was obviously a lot of concerns expressed by both pathways and individual producers, but realistically, how great was the threat that you felt that the bill was imposing on the industry that you needed to pull back on sharing the information you felt you needed to share?

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

I think the unintended consequence of Bill C-59 is that it stifled the discussion. In Canada, we need to have robust discussion on energy policy because it's such an important part of our economic fabric of this country. Not having certainty over things like what are international standards and what are we being held to has kind of stifled that debate. Now, as Jeff mentioned, we see a process in place to try and get some clarity around that. My hope is that will happen sooner rather than later, which will allow us to, again, start talking about the good things this industry is doing with regards to our efforts on carbon dioxide emissions and environmental performance.

Chris Varcoe – Journalist, Calgary Herald

Thank you.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Thanks, Chris.

Operator

Your next question comes from Robert Tuttle from Bloomberg News. Please go ahead.

Robert Tuttle – Journalist, Bloomberg News

Yes. Hi. You answered my question just a minute ago, but I want to just follow up on the TMX question. When do you see that spot capacity filled up on that? Is it going to take until all the pipelines are filled, or do you think it's going to be competitive before that time?

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Yes, Robert, I'm going to let Jeff answer that question. He's much closer to that than I am.

Geoff Murray – Executive Vice-President, Commercial, Cenovus Energy

Hi, Robert. It is Geoff. That's a good question in terms of the racking and stacking of various forms of egress from Alberta. I would say two things. Currently, the overall tariff around that pipeline is still to be settled. However, based on current projections and currently where it is set, we then have to look to the prices of commodity at the end of the pipe. We do see Gulf Coast deliveries, Mid-Continent deliveries, and West Coast deliveries all intrinsically linked through global pricing. Given if those relationships hold, and that's predominantly set by shipping, we do believe that the cost of spot will see Trans Mountain be near the end of filling. It is on a cost basis relatively higher than other alternatives, and so it will fill towards the end of filling all available capacity. Again, that's forward-looking. What we don't know is what will come along next to create the egress that Jon was speaking about. Markets are fluid, and they continue to move around, and that can have an impact on everything I've just said.

Robert Tuttle – Journalist, Bloomberg News

With TMX, you don't see it being utilized at full capacity for a couple of years, maybe two or three years, something like that?

Geoff Murray – Executive Vice-President, Commercial, Cenovus Energy

I think that comes to individual supply-demand forecasts and how quickly many various producers come along, and then you look to the future of how does operability go and where are various other pieces of infrastructure and how are they running. I think reasonably, we're not going to expect to see all of current egress filled in the next year, and I think Jon really put it well. Is it two years? Is it three years? Is it five years? Time's going to tell, but you've got it well-bounded in that range.

Robert Tuttle – Journalist, Bloomberg News

Okay, thank you.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Great. Thanks, Robert.

Operator

I will now turn the call back over to Jon for closing remarks.

Jon McKenzie – President and Chief Executive Officer, Cenovus Energy

Thank-you very much for participating in the call today. We certainly appreciate the interest in the company. Thank--you for your questions and take care and have a great rest of your day.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect. Thank you.