Cenovus Energy Inc.

Q1 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 first 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 their 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 Ms. Sherry Wendt, Vice-President, Investor Relations.

Please go ahead, Ms. Wendt.

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

Thank you, Operator. And welcome, everyone, to Cenovus's 2022 First Quarter Results Conference Call.

Please refer to the advisories located at the end of today's 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 AIF 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'll 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 please also 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, everyone. I want to start with our top priority as always, which is health and safety. We continue on our top-tier safety journey. Over the past month, our safety performance has fallen short of our own expectations. While, thankfully, the incidents were at the relatively minor end of the spectrum, such as slips on ice, they reinforce our need to be unrelenting with our focus in getting everyone home safely from their jobs.

Turning to our handling of COVID-19, I'm pleased to report that we welcomed our corporate Western Canadian staff back to the offices earlier this month. This is the first time in two years as a combined company that we've reopened our head office without major capacity restrictions, and I have to say it's been great to have the full team here in person again. For some teams, this has been the first opportunity to collaborate face-to-face since the Husky transaction. And with that being said, we know that COVID-19 hasn't disappeared, and we obviously continue to closely monitor the situations.

Now regarding our announcement this morning about increasing shareholder returns. Since I came to this company, our leadership team has been focused on positioning the balance sheet for increasing shareholder returns. I'm excited that our new framework reinforces alignment of the company with our shareholders on the importance of long-term balance sheet strength as a foundation for strong and increasing shareholder returns over time.

Our board has approved tripling the base dividend on our common shares, effective for the second quarter dividend. They've also approved the introduction of potential variable dividends in addition to our continuing share buyback program.

We've also implemented a net debt floor of $4 billion, which represents a leverage ratio of about 1 times adjusted funds flow at a US$45 WTI price. This provides shareholders more certainty around when they would receive incremental shareholder returns with a balance sheet rapidly improving.

Between $9 billion and $4 billion net debt, we will target 50 percent of excess free funds flow towards shareholder returns and the remainder to the balance sheet. Our preferred mechanism for that will be share buybacks, which we'll continue to execute opportunistically to the extent our share price remains below intrinsic value at around US$60 WTI.

If the value of share buybacks in a quarter is less than 50 percent of excess free funds flow, we'll use variable dividends to make up the difference. When reported net debt is at the $4 billion floor, the company will target to deliver shareholders 100 percent of that quarter's excess free funds flow. Again, our preference will be for opportunistic buybacks with variable dividends to make up the difference.

You will also continue to see the same capital discipline that you have come to expect from us. The five-year business plan we laid out for you at our Investor Day in December remains in place, and we will continue to test investments in our business based on returns at the bottom of the cycle, including a US$45 WTI price.

So let’s turn to financial results. In the first quarter, we generated cash flow from operating activities of $1.4 billion and adjusted funds flow of $2.6 billion, our best financial results so far as a combined company.

Capital spending was $746 million, which led to a free funds flow of over $1.8 billion overall in Q1.

This financial performance, combined with proceeds from asset sales achieved in the first quarter, enabled us to reduce our net debt to $8.4 billion at March 31st.

Our net debt reduction was impacted by a build of working capital in the quarter, primarily due to higher crude oil and refined product pricing.

So turning to operations in the first quarter.

Our upstream assets have been performing exceptionally well, including delivering total upstream production of around 800,000 BOE per day in the quarter.

Oil sands production was nearly 600,000 barrels per day, once again demonstrating the strength and dependability of these top-tier assets.

Production at Christina Lake averaged around 254,000 barrels per day in the quarter, and I think this clearly reflects not only the strength of the reservoir but also speaks to the capabilities of our operations team. They are continuously improving and innovating with our ongoing redevelopment and redrill programs.

Looking ahead now for a moment. We recently commenced the planned turnaround at Christina Lake, so you should expect that to impact second quarter production by around 20,000 barrels per day.

At Foster Creek, production for the first quarter was nearly 200,000 barrels per day and, as expected, we are seeing a modest decline from the prolific West Arm pads that we’ve recently brought into service. These are some of the best SAGD wells drilled in the industry, and this decline from peak rates was as expected.

Meanwhile, we have commenced another redrill program, which we expect to maintain around 200,000 barrels per day of production at Foster.

The Lloydminster thermals also continue to produce very reliably, delivering an average of more than 96,000 barrels per day in the quarter. With the application of Cenovus operating strategies here, and now with increased gas injection and a redrill program, the team has brought production back to over 100,000 barrels per day.

In addition, the Spruce Lake North project remains on track and will contribute another 10,000 barrels a day of production at Lloyd by the end of this year.

You've already seen how Cenovus was able to significantly improve the operating performance at the Lloydminster assets by implementing our operating strategies. And as we told you at our Investor Day in December, this year, we're going to be taking a much closer look at Sunrise.

Production at Sunrise in the quarter was 24,000 barrels per day net to Cenovus. Since the quarter has ended, production has reached over 25,000 barrels per day as we see additional benefits from our operating strategy rollout.

The facility has a nameplate capacity of 30,000 barrels a day net to Cenovus, and we are confident we can achieve this level of production over time.

Our realized prices for oil sands were very strong in this quarter, supporting an average oil sands netback of over $56 per barrel.

Overall, the Oil Sands segment generated $2.2 billion in operating margin in the first quarter.

So why don't we turn to conventional. Operations in that business continue to provide strong results, generating an operating margin of $263 million in the first quarter with production of more than 125,000 BOE per day.

We benefitted from our Q4 winter drilling program coming into production, allowing us to take additional advantage of higher AECO prices. And while still early, initial results have been better than anticipated.

Our offshore operations delivered 76,000 BOE per day of production and an operating margin of more than $450 million in the quarter.

We continue to see very strong gas demand in China, and we're having constructive discussions with our partners there on opportunities to increase our gas sales to help offset some of the forecast reduction in contracted natural gas from Liwan 3–1.

We also continue to progress our growth projects in Indonesia with the M fields. This month, we commenced drilling the first of five planned development wells in the MDA field. The MBH and MDA fields are expected to start producing later this year.

The new production is dry gas and is expected to increase Indonesia to around 20,000 BOE per day by year-end 2023, from current rates of around 10,000 BOE per day. You can expect some ramp-up to begin in Q3 of 2022.

In the Atlantic region, the business delivered unit netbacks of more than $83 per barrel, reflecting production of 14,000 barrels per day and higher overall commodity prices.

The Terra Nova floating production storage and offloading vessel remains in drydock in Spain and is expected to return to operation near the end of the year. This will add about 10,000 barrels per day of production by year-end.

We also expect to make a decision on the West White Rose project with our partners in the coming weeks. We have taken the time over the past 16 months to substantially de-risk this project. As far as any decision to proceed with development, it must represent meaningful increased value for Cenovus shareholders relative to decommissioning.

West White Rose is, right now, around 65 percent complete. And if the decision is made to move forward, we estimate production net to Cenovus would ramp up by 2026 to a peak of around 45,000 barrels per day by the late 2020s.

Shifting to the downstream. In the US Manufacturing segment, utility refinery utilization increased to 80 percent in the quarter and generated $423 million in operating margin. This reflects stronger margin capture during the quarter with a much-improved price environment in March.

In a rising price environment like we had in Q1, our results also reflect the net benefit from the First In, First Out accounting of our US refineries.

Throughput in the quarter was impacted by some extended downtime at the Lima refinery, as well as planned and unplanned maintenance at our joint venture refineries.

Looking ahead, the Toledo refinery began its once-in-every-five-years turnaround in mid-April. The refinery will be down for a large part of the second quarter, and you should expect to see some higher unit operating expenses in Q2, given turnaround costs and lower utilization rates.

In our Canadian Manufacturing segment, we saw utilization of 89 percent at the Lloydminster Complex in the first quarter, with an operating margin of $114 million. The refinery ran well. However, throughput was impacted by an unplanned outage at the upgrader. We also reduced run rates later in the quarter as we prepared for planned maintenance that began in April.

So turning now to our 2022 corporate guidance updates.

We have updated our commodity price assumptions to better reflect the current business environment. We've increased our guidance ranges for oils sands royalties and cash taxes as a result. We've also revised our oil sands per barrel OpEx ranges to reflect higher AECO prices, which drive our fuel costs across the business.

On the CapEx side, due to inflationary impacts on labour and supply chain, as well as increased costs stemming from COVID-19 impacts, we revised total estimated rebuild capital for the Superior Refinery by $300 million.

That said, overall insurance proceeds related to Superior will still largely offset the rebuild capital. To date, about $1.1 billion has been received in insurance proceeds related to Superior, and we expect about another $100 million to come in around the second quarter this year.

In terms of an update on the rebuild itself, we remain on schedule to restart by the end of the year, and we very much look forward to that day. With a nameplate capacity of 49,000 barrels per day, Superior will be an important addition to our heavy oil value chain as the first stop on the Enbridge Mainline.

I'm just going to take a moment to talk about sustainability.

As you likely saw earlier this month, the federal government announced an investment tax credit for carbon capture, utilization and storage projects. This is a positive step in working collaboratively with governments to help Canada achieve its climate goals and ensure the country can be the world's preferred supplier of responsibly produced oil.

We applaud the federal government for recognizing the importance of both developing new technologies to help Canada fight climate change, but also the vital role our industry will play in supporting our country's energy security and economy.

We continue to have discussions with the government to determine how the investment tax credit will be implemented, as well as what other support will be available to advance GHG-reduction technologies. Those details will help inform our capital allocation decisions as we move forward our target to reduce our absolute scope 1 and 2 emissions 35 percent by 2035, and our 2050 Net Zero ambition.

So as I look forward to the rest of the year and beyond, I am really excited about the future of Cenovus. Commodity prices have recovered substantially in the past two years, and I am seeing a growing acknowledgement of the important role our industry will play in helping the world diversify to a lower-carbon economy while protecting jobs, economic contribution, and global energy security.

We are setting up for even stronger momentum in Cenovus's business for the second half of the year. Our assets will reach full operations across the business after completing important planned maintenance in the first half of the year. The WTI price risk management program will have largely wound down. We expect to see higher downstream margins with improved market cracks. And the contingent payment to ConocoPhillips expires as of May 17th.

We've built this business with a focus on free funds flow generation, and we've made rapid progress on the balance sheet. We've also executed on 40 percent of our current share buyback program. That represents over $1 billion above the base dividend that we've returned to shareholders since we put the buyback program in place. And today, we've laid out a clear path for how we will continue growing shareholder returns while positioning the balance sheet to support the returns growth profile for years to come.

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

Q&A

Operator

Ladies and gentlemen, as a reminder, you can join the queue to ask a question by pressing *, 1.

We will now begin the question-and-answer session and go to the first caller.

Dennis Fong, CIBC Capital Markets, please go ahead.

Dennis Fong — CIBC Capital Markets

Hi. Good morning and thanks for taking my questions.

The first one, actually, is related to the share buyback program. In your comments, you alluded to being about 40 percent complete thus far. Just given the strength in commodity and the potential situation around decisions around returning capital and what the return of buying back stock happens to be, how should we be thinking about a scenario where you complete your prescribed 10 percent NCIB prior to the timing of a renewal, potentially, in the November time frame?

Does that just shift automatically to variable dividends? Or is there other mechanisms you could look at buying back stock if the economics or the return still is favourable?

Alex Pourbaix

Maybe I'll start out, and Kam or Jeff may want to jump in, or Jon. But we've always said that share buyback is, for us—I mean, as long as we're in the ranges that we're thinking about, I mean, it is a preferred mechanism for returning value to shareholders. And I've always said it's opportunistic. And if we find that we end this program and our share price is still at a very attractive level, I think we're going to take a very hard look at continuing it.

I don't know if anyone else has any comments they'd want to add.

Kam Sandhar — Executive Vice-President, Strategy & Corporate Development, Cenovus Energy Inc.

Yeah. Dennis, thanks for the question.

I would just add, you shouldn't think about the NCIB as a limitation to buying shares. Whether it's the NCIB and us renewing it, or even looking at an SIB, we'll always have some option available to us as we think about the strategy going forward.

And so, the real gating item there is the point Alex made, which is looking at what our intrinsic value at $60 is. And if we see a share price that's attractive, we'll continue to buy shares; if not, we'll shift to the variable dividend.

Dennis Fong

Great. Great. Appreciate that colour.

My second question, or my follow-up, I guess here, is just related around the portfolio of assets that you have right now. I know that, by and large, you have completed a lot of the rationalization and the optimization of said portfolio. Just given that your balance sheet is in a considerably better position, how should we be thinking about how you evaluate further capital allocation from more of a CapEx perspective of things?

I know you've outlined West White Rose, but more along the lines of other incremental growth projects, and/or assets to either be bought or sold?

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

Hi, Dennis. It's Jon McKenzie.

I think, just addressing the latter part of your question first, just in terms of dispositions, one of the things we did, post the acquisition of Husky, is we did a comb-through of all the assets to look at assets that were on strategy versus assets that are not on strategy or non-core. I think we've been pretty clear we’re getting close to the very end of that program. I think we still need to close on the retail assets, but don’t think about this portfolio that we’ve got today as being something that isn’t completely congruent with our strategy.

As we think about growth and think about capital investment, we have a pretty firm capital allocation criteria, and it’s all rooted in bottom-of-the-cycle pricing and generating cost of capital returns. We’re above at $45. So we do think—and every dollar that we invest needs to generate a return for our shareholders at those pricings, so we still screen everything there.

When we think about the pricing environment that we’re in today, there are additional opportunities to do some short cycle things. And Alex mentioned some of the growth projects that we’ve got, that are going to come on later this year, whether that be Indonesia or Spruce Lake North or, later in the year, we’re got Terra Nova coming back on station. But we are kind of very religious on how we allocate capital, living within that framework.

Dennis Fong

Perfect. No. I appreciate that colour. I’ll turn it back and let others ask questions. Thanks.

Alex Pourbaix

Thanks, Dennis.

Operator

Thank you.

We’ll take our next question from Greg Pardy with RBC Capital Markets.

Greg Pardy — RBC Capital Markets

Thanks. Good morning and great rundown. So I just—I want to stay with that buyback a little bit. And maybe I'll try and put words in your mouth. But I'm wondering if you can maybe provide some perspective on whether your shares today represent compelling value?

And then, secondly, to the extent that, that intrinsic value is NAV-based, as your deck goes down, that intrinsic value presumably would continue to head north here. So I mean, could we be in a situation where, I mean, shares just continue to be just the preferred method?

Alex Pourbaix

Yeah. I think, Greg, I would largely agree with the comments that you made. And I think the important thing, as Kam mentioned, is that we really do target share buybacks at middle of the cycle. So while I probably won't share our exact view of where our NAV is, we do look at it—we do calculate that in the context of kind of a $60 WTI and other middle cycle numbers for the other important metrics in our business.

And you are accurate. As we continue to execute on this plan, we would expect to see that continue to grow, which I think would continue to leave us with opportunities, depending on where the share price goes. But all things remaining static, I mean, we would see a continuing opportunity to buy back shares.

Greg Pardy

Okay. Okay. Thanks for that.

And then maybe just switching, just on the operations side, just to Liwan. Is there any commentary you can provide around just extension of gas sales contracts—how pricing could look in that market at Liwan?

Drew Zieglgansberger — Executive Vice-President, Natural Gas & Technical Services, Cenovus Energy Inc.

Yeah. Hi, Greg, it's Drew.

So yeah, with Liwan 29–1, we've actually just finished a negotiation for a supplemental contract sale. So we are increasing that sales contract volume there. Pricing is still very strong, as you see. It's probably still some of the best netbacks we have in the company. So pricing around that negotiation is at least as good as that.

Having completed that negotiation here, literally just in the last week or two, we are quickly shifting to 3–1. There's very strong demand in that area for gas. We've got a lot of good reserve base there, and so we are quickly shifting now, our focus, to potentially reinstate or look to add a supplemental sales agreement in the 3–1 area as well. And again, pricing is quite strong, and we'd expect to be in the similar—at least at similar pricing that we've had for the last number of years.

Greg Pardy

Okay. So with what you've just told me, can I—is it fair to assume I can sort of think about Liwan as being kind of flat into '23, '24, at similar pricing scenarios?

Drew Zieglgansberger

We'll provide guidance later this year as we go into '23 budget, Greg. But the 29–1 Liwan contract we just finished, actually, is incremental volume to what we've had in the past.

Greg Pardy

Okay. Okay. Good. Now thanks very much.

Drew Zieglgansberger

Yeah. Thanks, Greg.

Operator

Thank you. We'll take our next question from Phil Gresh with J.P. Morgan.

Phil Gresh — J.P. Morgan

Hey. Good morning. I just wanted to ask first about the updated debt target. In the past, you've talked about 1 times EBITDA or $6 billion of debt. Now you're talking about 1 times cash flow or $4 billion of debt. I presume the EBITDA versus the cash flow are roughly equivalent, but I just thought I'd clarify on that.

And then, just in terms of this lower absolute debt target of the $4 billion, is it just a desire to have a bit lower debt which, obviously, would make sense? Or something different? Just wanted to unpack that a little bit more, if there's anything to add.

Kam Sandhar

Thanks, Phil. It's Kam. Maybe, what I would say to that is I think, broadly speaking, the debt target, yes, has come down. When you look at our cash flow at $45, it's probably in that 4 to 4.5 range, so it does equate to approximately 1 times.

I think one of the things we spent a lot of time thinking about, as we put this framework together, is the trade-off between moving towards, say, the 100 percent of excess free funds flow going back to shareholders, and where we want to take the balance sheet from a no-regrets perspective.

So I think $4 billion, from our perspective, is the right level to be, if we're going to commit giving back all the cash flow once we get there. Then, it really allows us optionality, whether it's continuing to opportunistically buy back shares, opportunities that could come up in the future that we would look at, and put the company in a really, really good position to be very opportunistic in terms of what can come.

So I think, at the end of the day, we were comfortable with $4 billion. I think we looked at all scenarios, from leaving it at $6 billion, to even going to no debt. And I would say, from our point of view, it's the certainty around having a clear floor was important to us, but also putting it at a level that felt appropriate, given the commodity price environment we're in, and where we'd like to be if commodity prices ultimately come down.

Phil Gresh

That makes a lot of sense. Seems like you could get there pretty quickly, actually.

And then just on the M&A side, since the framework does allow for M&A, just wanted to ask a little bit more here. You've talked about the potential to clean up your Downstream JV structures.

Curious if that's something that you would consider somewhat of a near-term priority for the company? And/or would you be considering upstream opportunities at this point? Just what are your latest thoughts on M&A?

Alex Pourbaix

I mean I—it's Alex, Phil.

I think I would say, with respect to M&A, we've always said it is very opportunistic. We're very value-focused when it comes to that. But we also prioritize shareholder—our focus is on shareholder value. And I do think we have some opportunities to continue to drive shareholder value by expanding margins. But ultimately, if we intend to continue to grow shareholder value, we are going to have to grow the top line.

But as I said, nobody should expect that there's any word salad here, we're looking to move away from the discipline that we've shown to date. We have talked in the past—and Jon may want to add a comment or two—but we do have some focuses on the downstream side, and that is owning and operating our assets, and we'll continue to look at that. But none of that should be looked at as we're going to lose any of the discipline we've shown to date.

Jon McKenzie

No. I think that sums it up well. I think we've been really clear, since we acquired Husky, that one of our strategic goals is to own and operate and have strategic direction over our business, particularly, I guess, in the US Downstream. None of that has changed, but as Alex mentioned, this has to be done within the framework of the financial discipline that we've set forth.

Phil Gresh

Okay. Great. So probably more downstream than upstream, I guess, is my takeaway if you're looking at things. Is that fair?

Jon McKenzie

Yeah. I mean, Phil—I mean, if you kind of look at our Upstream, and then you stick within the North American context, we operate most of what we participate in and then quite the opposite in the US Downstream. So it's just really a function of the asset base versus a preference one way or another.

Phil Gresh

Understood. Thank you very much.

Operator

Thank you. And once again, that's *, 1 if you would like to ask a question.

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

Neil Mehta — Goldman Sachs

Thank you. And, Alex and gentlemen, start by congratulating you. The last 18 months have been terrific for the business. And the fact you can culminate this with a very clear return-of-capital strategy shows how long—how far the business has gone. So congrats on the progress.

Had a couple questions for you. The first is around capital spending levels being bumped up this year. It looks to us to like that's just Superior, so. But is there any of that that you think that carries forward, given the inflationary forces that the industry is contending with?

And then, as it relates to Superior, just any update there about the confidence of getting that project online? And how do we think about insurance proceeds potentially offsetting some of that higher spend? Thank you.

Alex Pourbaix

Sure, Neil. As to your first question, that capital increase relates exclusively to Superior. We are seeing—we're starting to see some cost pressures in the business, and maybe we can get some comments from some of the other leadership team. But maybe I'll first have Keith talk about how we feel we're doing on Superior.

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

Hey, Neil. Thanks for the question.

Just in Alex's opening comments, he talked about the strategic nature of Superior being important to us. It is the first stop on the Mainline system. It helps us mitigate our heavy oil—heavy-light spread in Alberta. And it does consume molecules and diversifies our product mix, so nothing's changing with regards to seeing it on strategy.

Even with the cost pressures that we're seeing—I think we talked about $1.2 billion of total capital costs, $1.1 billion of insurance proceeds already received, with another $100 million to come. So I think we've always been saying, essentially, offset by insurance proceeds, which still holds.

And the other thing I would offer up is even though we're seeing some of these cost pressures, we're not seeing schedule slippage. So we're still on track to start up and operate the refinery at full rates in Q1 2023, so still looking good on kind of the overall schedule.

Drew Zieglgansberger

Yeah. Neil, it's Drew here. Maybe I'll jump in on the first part of your question.

So what I would say—and to represent, probably—Norrie's area and our supply chain team have actually done a really good job in kind of the thermal oil sands business, where we've got longer-term, sustaining, program-based capital being deployed. They've actually done a really good job of being well ahead of some of this pressure that we were seeing. We've got almost—the long-lead items are all kind of on the ground. We're well ahead on tubular buying and whatnot. So that business is probably a little more insulated from some of this near-term pressure.

But what I would say in more of our conventional short-cycle business, we're just in breakup now. We started seeing a lot of pressure right near the end of kind of the completion frack drilling season here.

And we are having a look now, over breakup, before we kind of restate our activity here midyear. We are having a look at what do we want to do from a capital level in the second half because we are seeing pressure on steel, drilling rigs, service rigs, particularly where we don't have multiyear contract commitments which, in a short-cycle business like our conventional world, historically, you haven't—we haven't pushed ourself to do that.

So we are having a look at that. We have to make some decisions here over the next quarter on what we want to do because we are seeing some pressure in that part of the area—in that part of our business.

Neil Mehta

Thanks, Drew.

And the follow-up is just around the Pathways project. Looks like we're getting closer to having some clarity around the government subsidies around it. But, Alex, would love your perspective on why you think this project's important. But also, more importantly for us, is just trying to figure out the timeline associated with spend and when you think that this could come into service, as it's difficult for us to val it into our models until we have a little more clarity around timeline.

Alex Pourbaix

Yeah. No. I'm happy to give a little bit of colour on that, Neil.

I think the government announcing the ITC was a really positive step and really does, I think, show that the industry, and particularly the oil sands industry, is represented by Pathways—has really had quite a good collaborative and productive discussion with the federal government.

I think we are still—I think, before you see the industry kind of announce an FID on the Pathways foundational project, which is really the carbon capture and the transport of the CO2 down to the Cold Lake area for sequestration, we're going to have to get a lot more detail around the ITC, around other programs that are also going to be—or I suspect will be in place to help industry fund and cover the costs associated with that.

But at the same time, we have made commitments for carbon reduction in the 2030 time frame. So I don't think you're going to have to wait very much longer. We're already budgeting, in our five-year plan, things around methane reduction, a lot of other initiatives, and those are already included. But I think you're going to see, over the next year or so, a lot more granular detail on the costs associated with those larger-scale projects.

Neil Mehta

Makes sense—

Alex Pourbaix

And then—sorry. And that's going to take us getting through these discussions with the various levels of government.

Neil Mehta

Yep. Makes sense. Thanks again.

Alex Pourbaix

No worries.

Operator

Thank you. We'll take our next question from Manav Gupta with Credit Suisse.

Manav Gupta — Credit Suisse

Thank you, guys.

Wondered about, actually, your view on the threefold increase in dividends. My question here is on dividend hike. I think in the past, you guys have indicated that even at $45 WTI, you can make over $4 billion in cash. And your CapEx is kind of $2.5 billion, so a threefold increase is great.

Just wondering—the dividend burden could be for $1.3 billion, so you could have gone with a fourfold increase, make the yield even more competitive, and so just trying to understand the thought process. Again, very appreciative of the threefold increase, but trying to understand the thought process of not making it a fourfold increase, if you could talk about that?

Kam Sandhar

Hey, Manav. It's Kam. So a couple things I would say. I think, first off, I think the base dividend, I would say, is one component of our shareholder return strategy. So I think you should really think about all three components as we think about what our value proposition is to shareholders.

I think, when you look at the base dividend in isolation, yes, we've tripled it. We have talked about having a capacity to grow that dividend, sort of in that $1 billion-plus range, over time, as we execute our business plan. And I think what's important there is, number one, is we have to continue to invest in the assets to make sure that, that dividend capacity is there through that five-year period that we outlined back in December.

So I think, very comfortable with the tripling here. We see lots of opportunity, I think, to continue to ratably grow it. I think one of the things that we're really mindful of is, continue to have a dividend that we can commit to and grow over the next five-year period. And so that increase that we've put in is really reflective of that. And I would say, as we continue to execute on the plan we've outlined, we see line of sight to continue to grow that over the next five years.

I think on top of that—obviously, the buyback program as we highlighted, we're $1 billion into it. But as we continue to see commodity prices stay even in this range, we expect we should get pretty close to that $4 billion debt target here, hopefully by the end of this year. And that's going to really pave the way for increased returns, both revisiting the base dividend, along with the other two components we've talked about.

Manav Gupta

Perfect. Plus, could you also comment a little bit on the much-improved performance in the Downstream, US Downstream in particular, in 1Q versus 4Q? I think you had some turnarounds in 4Q. But even at 80 percent utilization, this was a much better quarter.

So you have some turnarounds coming up in 2Q but, overall, how do you look at the Downstream margin environment where we are for the second half of this year? Will you be running all out? And it looks like product cracks are pretty strong at this point of time.

Keith Chiasson

Hey, Manav. It's Keith Chiasson here.

Yeah. What I would say is we started seeing the turnaround in the March time frame. Cracks, early in the year, were still a little tighter. But we were able to capture those with Lima running relatively full out in the March time frame.

But as you alluded to, Q2 is a pretty heavy turnaround period for us, both in the US as well as in Canada. So we'll have a lot of our joint venture assets, refined assets offline and our Canadian assets offline throughout the quarter.

So we are looking forward to Q3, where a lot of that turnaround activity's behind us. Utilization will increase. And as we look forward to kind of product markets, we're seeing a pretty robust market. Gasoline demand is kind of back to pre-COVID levels. Diesel demand is well above pre-COVID levels. And jet demand is still behind but coming back. So it's actually setting up pretty well for a really good back half of the year.

Manav Gupta

Perfect. My last quick one is, when we envision a scenario in two or three years, when if the price is right, then Cenovus is the operator of the BP Sunrise as well as the operator of BP Toledo . So you have European guys who are trying to move out of oil sands for whatever reason that they're finding. And if the price is right, is there a possibility that you are the sole operator and owner of both Sunrise and the Toledo refinery?

Thank you. I'll leave it there.

Alex Pourbaix

Well, Manav, I guess anything is possible. You might want to go ask our partners what they think of that. I'll probably demur for the time being.

Manav Gupta

Okay. Thank you.

Alex Pourbaix

Thanks.

Operator

Thank you. We'll take a follow-up from Dennis Fong with CIBC Capital Markets.

Dennis Fong

Hey. And thanks for taking my second round of questions here. Just in your opening commentary, you alluded to some of the great work that your asset teams are doing at Foster Creek and Christina Lake in terms of showcasing really strong production volumes from those two assets.

I was just hoping to maybe get a bit of an update from—I know it's only five months into your five-year plan, but just around the—about $1 billion worth of operating margin improvements that you can see from the oil sands in the downstream side. Just wanted to get a bit of an update there as to how you're seeing some of the optimization work at FCCL, some of the application of Cenovus's operating model on the ex-Husky assets, as well as the margin expansion opportunities at WRB and at Toledo which, I presume, could come through after this major turnaround. Thanks.

Alex Pourbaix

Yeah. No. Happy to do that, Dennis. Maybe what I'll do is I'll get Norrie to talk about the Upstream side, and Keith can maybe chip in on the Downstream side.

Norrie Ramsay — Executive Vice-President, Upstream – Thermal, Major Projects & Offshore, Cenovus Energy Inc.

Okay. Hi, Dennis. Norrie here. Yeah. Just to start with our Upstream optimization. We've, as you know, been applying our FCCL processes across into the legacy assets that we've purchased. Kind of the biggest solid one is in the Lloyd thermal area. We've really put a lot of effort and investment into the asset. What we've been doing is we've been adding what we call NCG. So we've been utilizing our steam as well as methane co-injection. And what this is allowing us to do is to deploy steam in the best areas as we kind of move forward.

We also have—I mean, so far this year, we've actually added about 20 well pairs to Lloyd. And again, what we're doing is putting them in optimal positions at longer wells. We're kind of applying our Foster Creek kind of processes, and you see that strong production coming through.

The other thing we're doing is we've identified, this year, an additional 28 redev redrill opportunities at Lloyd thermal and—but again, these are basically areas that have been steamed up already. And we're able to drill into these areas and evacuate the oil, basically very cheaply.

So we expect that to continue over the next number of years as we kind of go forward. And similarly at Sunrise, we are actively putting in place an investment program with a four-well-pad program. And as that's going to take in shape, we're also—we have 11 redev redrill opportunities this year. And that's kind of—as you'll see, is keeping our production very strong as we go forward.

So everything's working as we theorized it would, and we expect to see this continuing over the next two or three years in the same vein.

Keith Chiasson

And, Dennis, Keith here, just picking up on kind of the margin expansion opportunities. Those opportunities are going to be coming real time at our Wood River Refinery. What was required is being executed during this turnaround process, so when it comes back out of that turnaround, it will have the improvements made to expand product yields.

And then on the Toledo turnaround, we're metaling up the refinery to be able to handle full high-TAN crude, so basically taking advantage of the discounted crude coming out of Canada.

When we think of further margin expansion, we are advancing the Rewire Alberta project, so a way to introduce Foster Creek and Christina Lake crudes into the upgrader and the refinery. That has several benefits. It allows us to recycle more of the condensate in the province. It allows us to expand our margin because we're using lower quality, lower cost crudes in the upgrader and the refinery versus LLB, which we'll then just sell to the market. And obviously, the expansion helps us on our unit costs and product make, so good initiatives underway there.

The other kind of margin expansions, obviously, is associated with TMX, scheduled to come online at the back end of 2023, early 2024. And we're a fairly sizeable shipper on that, so that'll give us opportunity to move our crude oil to higher value markets.

And then the other big one in the margin expansion is just around turnaround schedules. So both Lima and Toledo have kind of gone through their one-in-five major turnaround cycles. And as we've seen in fourth quarter of 2021 and this quarter coming up, it has a pretty sizeable impact on not only utilization but also cost. So those are now through their five-year turnaround cycles, so it's a pretty good runtime for those two refineries going forward.

Dennis Fong

No. Perfect. That was a great summary, really appreciate it. Thank you.

Alex Pourbaix

Yeah. No worries. Thanks, Dennis.

Operator

Thank you. We'll hear next from Chris Varcoe with the Calgary Herald.

Chris Varcoe — Calgary Herald

Hi. This is a couple of questions for Alex regarding the CCUS.

Is the federal investment tax credit enough, to your mind, to proceed with Phase 1 of the Pathways foundational project? Or do you need to see some sort of incentives and assistance from the province of Alberta?

Alex Pourbaix

You know, Chris, if you take a look around the world, where CCUS projects have gone forward, what you've generally seen is government participation in both capital—is often at the kind of 60 percent to 70 percent level. There's usually some operating cost support.

So as I kind of alluded to, I think the investment tax credit is a very good start. I think we're certainly—as an industry, we're going to require some more help at a steady state to probably go forward with these really meaningful, large-scale CCUS projects. And I would suspect there'll be contribution from both levels of government, ultimately, in that.

Chris Varcoe

Just to follow-up, then.

With such strong earnings, how do you explain to the public, I guess, a need for an ITC? But also, maybe, financial assistance from the province of Alberta?

Alex Pourbaix

Yeah. It's funny, Chris. I'm always interested in these debates about commodity prices. And one of the elements of it is, I think, everybody on both sides of the debate has a very short memory. And I personally have a pretty long memory about this, and I remember oil being about $10 a barrel a couple of years ago. And if you take a look at where oil—at the average price of oil over the last sort of 10 or 12 years—I haven't looked at it recently, but I would expect it probably looks more like $50 or low $50s a barrel over that time period.

So oil prices go up, oil prices go down, but when we make these kind of investments, these are—the kind of investments like that Pathways foundational project, these are multibillion-dollar projects. And we have to have certainty that they are investible, and that we can manage those investments over the entire commodity price cycle.

So although—oil prices right now are obviously very attractive, we know, probably before that project is ever in service, we'll probably test the bottom end of those prices again. So we really have to look at this over the long term. And I suspect, over the long term, much as we've seen in other jurisdictions, we're going to require a real collaboration, both from industry, who will invest tens of billions of dollars in these projects, but we're also going to need some support from government. We're really talking about a massive change in how energy is produced and delivered as we decarbonize the upstream.

Chris Varcoe

Just finally on that front, what work is going to be done this year on Pathways? When do you anticipate an FID to be made?

And you talked about the fact that you needed more details, and I guess I'm just wondering what details do you still need to have in hand before you can make that FID decision?

Alex Pourbaix

The larger scale announcement of the ITC has obviously occurred, but there's going to be a lot more detail about how that ITC is going to work. And that is really just—that just takes the government a little bit of time to come out with that information.

Right now, for us, the Pathways group, we have already commenced preliminary engineering for that foundational project, the carbon capture at site, the transport on the CO2 trunk line and, eventually, the sequestration. We're in the process of making application to the Alberta government for pore space to get in there, and we have kicked off significant work, environmental work, and the other studies that are required for the permitting, the application for the permits to ultimately develop and construct that project.

So there's actually a huge amount of work going on. The Pathways partners, we have seconded literally dozens of people into the organization, with more to come. So we are in full-scale development mode right now at Pathways.

Chris Varcoe

Thank you.

Alex Pourbaix

No worries. Thanks, Chris.

Operator

Thank you. This—thank you. That does conclude today's question-and-answer session. I'd like to turn the conference back over to Mr. Pourbaix for any additional or closing remarks.

Alex Pourbaix

Well, thanks very much. And thanks, everybody, for your continued interest in the company and taking time this morning to spend with us. So once again, thanks, and we'll let everyone get back to their day.

Operator

Thank you. That does conclude today's conference. Thank you for your participation.