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Weekly Commentary

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Cenovus Energy
– Investor Day Highlights Management's 5-year Plan

Cenovus Energy Inc. (TSX/NYSE: CVE) is a Canadian energy company with oil & gas exploration activities in Western Canada, Atlantic Canada and Asia Pacific regions. In addition, CVE conducts upgrading, refining and marketing operations in Canada and the United States. In January, the company closed its all-stock combination with Husky Energy, thus creating an integrated Canadian oil and gas company with a diverse portfolio of upstream and downstream operations. The combined entity, which carries a $31.7 billion market cap, makes CVE Canada's third largest oil and natural gas producer and the second largest refiner of products.

Last Thursday (Dec. 9) CVE held its '2021 Investor Day'. At the event, which was held virtually, management announced the details of its 5-year business plan which will focus on five key objectives: maintaining financial discipline, improving cost management, growing free funds from operations, returning capital to shareholders, and defining ambitious targets regarding the environment, operational sustainability, and corporate governance (ESG).

Capital spending in 2022 is projected to fall between $2.6 to $3.0 billion. Approximately $200 -$250 million will be allocated to rebuilding the **Superior Refinery** located in Superior, Wisconsin. The refinery, which was operated by Husky, was heavily damaged by an accident while undergoing maintenance in April 2018. Anticipated to be operational by early 2023, the refinery will have the capability to process 49 thousand barrels (Mbbls) of oil per day. Approximately $100 to $150 million will be spent on the **Terra Nova** life extension project located in Newfoundland and the **Spruce Lake North** thermal project located in Saskatchewan. Another $100 to $150 million will be allocated to the completion of the Husky integration which has successfully reached its target of $1.2 billion in synergies.

Daily 'upstream' production in 2022 is expected to be in the high/low range of 780,000/820,000 barrels of energy equivalent per day (BOE/d). The Canadian **Oil Sands** segment is expected to contribute 570,000/630,000 BOE/d with Western Canadian **Conventional** assets producing 118,000/134,000 BOE/d and the Atlantic Canada **Offshore** segment adding another 64,000/76,000 BOE/d. With demand on the upswing following depressed pandemic-related levels, 'downstream' upgrading and refining should increase to 530,000/580,000 BOE/d. Allocation of

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capital to exploration is likely to remain muted for years to come as the oil patch continues to prioritize debt repayment and returning capital to shareholders over growth.

Crude oil prices, as measured by benchmark **West Texas Intermediate (WTI)**, have rebounded strongly since bottoming in April 2020. In fact, CVE is well positioned to grow earnings and free funds flow (FFF) with WTI as low as US$45. With WTI currently trading in the low $70's and between a low of US$62 to a high of US$85 since May, strengthening prices will continue to offer significant opportunity to enhance returns to shareholders. The more prices rise, the better this story gets. Scenarios over the 5-year plan imply cumulative FFF of approximately $11 billion at US$45 WTI, $23 billion of FFF at US$60 WTI, and $33 billion of FFF at US$75 WTI *(source: CVE Investor Day).*

The current dividend, which was doubled in Q4, is sustainable at $45 WTI. The company also met debt reduction targets to realize net debt below $10 billion. Management reaffirmed that 50% of excess FFF in 2022 will be allocated to shareholder returns though dividends and opportunistic share buybacks of up to 146.5 million shares - approximately 9% of the float by our calculations. Management believes operational costs can be trimmed by 7% and that administrative and sustaining capital costs can stay flat.

ESG targets are firmly entrenched in the 5-year plan. Over the long term, CVE aims to reduce greenhouse gas (GHG) emissions from operations by 35% by 2035 and reach 'net zero' by 2050. Plans are in place to reclaim 3,000 decommissioned wells by the end of 2025 and to reduce oil sands water intensity by 20% by year-end 2030. In support of reconciliation, a minimum of $1.2 billion is being allocated to supporting indigenous businesses through 2025. Given the growing importance investors are placing on environmental sustainability and progressive corporate behavior, scoring well in ESG assessments adds value and reduces operational risk.

In our view, long-term sustainability of the oil and gas industry will be dependent on change. Keep in mind, global demand for fossil fuels is projected to grow significantly over the next two decades. Transitioning to 'green energy' like renewables will require unprecedented international cooperation, oversight, innovation, and investment. To believe we can transition rapidly is simply an irrational denial of reality. In the meantime, we believe Cenovus is undergoing its own transition by becoming a leader in GHG reduction, technological innovation, and its commitment to environmental stewardship which includes membership the **Canadian Oil Sands Net Zero Project**, a topic we wrote about in our June 9 letter (www.palos.ca, Issue 38 - Climate Change: Oil Sands Pathway to Net Zero Project).

Cenovus is well positioned to grow returns to shareholders while remaining a progressive, highly sustainable energy company. The **Palos Equity Income Fund**, the **Palos Income Fund LP**, and the **Palos-Mitchell Alpha Fund** are currently invested in shares of CVE.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$9.85	19.78%
Palos Equity Income Fund - RRSP	PAL101	$7.59	20.10%
Palos Merchant Fund L.P. (Dec 31, 2020) [2]	PAL500	$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL213	$18.48	43.73%
Palos-Mitchell Alpha Fund [3]	PAL300	$10.68	28.10%
S&P TSX Composite (Total Return with dividends reinvested)			22.88%
S&P 500 (Total Return with dividends reinvested)			27.14%
S&P TSX Venture (Total Return with dividends reinvested)			3.94%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			1.48%
Canadian Government 10-Year			1.47%
Crude Oil Spot			US $71.67
Gold Spot			US $1,782.90
US Gov't10-Year/Moody BAA Corp. Spread			180 bps
USD/CAD Exchange Rate Spot			US $0.7858

[1] *Period ending December 10th, 2021. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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