Canadian Oil Sands

2014 ANNUAL REPORT

# 50 YEARS OF LEADERSHIP AT SYNCRUDE

# 50 YEARS OF LEADERSHIP AT SYNCRUDE

1964 50 Syncrude 2014

In 2014, Syncrude Canada Ltd. (Syncrude) marked its 50th anniversary. Formed in 1964, the Syncrude project helped establish the commercial viability of Canada's oil sands, the third largest proven oil reserve in the world. Through a bold vision, ingenuity and tenacity, Syncrude helped invent an industry that today provides a secure source of energy to power our lives.

Over its 50-year history, Syncrude has demonstrated leadership in technological innovation, environmental stewardship and investment in the community. Billions of dollars have been invested in infrastructure to process decades of oil sands resource, and Syncrude's future remains rich with opportunity.

Syncrude is an unparalleled oil sands asset, and Canadian Oil Sands is proud to be its largest owner. Congratulations, Syncrude! We look forward to another 50 years of leadership.

---

Canadian Oil Sands Limited (COS) is a pure investment opportunity in light, sweet crude oil. We are the largest owner in the Syncrude project with a 36.74% interest. Through our Syncrude asset, COS offers a long-life crude oil production stream, potential growth through high-quality oil sands leases and a history of paying dividends to shareholders.

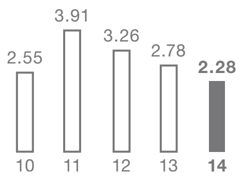
Our shares trade on the Toronto stock exchange under the symbol COS and on the OTCQX under the symbol COSWF. Based in Calgary, Alberta, the COS team provides operations oversight of our interest in Syncrude, crude oil marketing, and financial, accounting, legal and investor relations services.

## CONTENTS

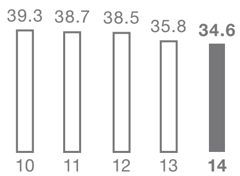
# 2014 RESULTS

Canadian Oil Sands

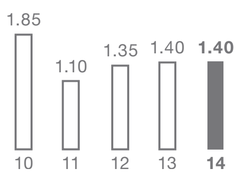
**CASH FLOW FROM OPERATIONS**
*($ per Share)*




**PRODUCTION**
*(millions of barrels, net to Canadian Oil Sands)*




**DIVIDENDS**
*($ per Share)*




| The financial results of the Corporation have been prepared in accordance with generally accepted accounting principles ("GAAP"). All references to "dollars", "$", or "C$"are in Canadian dollars and all references to "US$" are in United States dollars | **2014** | 2013 | % change |
|---|---|---|---|
| **FINANCIAL** ($ millions, except per Share amounts) | | | |
| Sales, after crude oil purchases and transportation expense | **3,419** | 3,565 | –4% |
| Cash flow from operations[1] | **1,106** | 1,347 | –18% |
| Per Share[1] | **2.28** | 2.78 | |
| Net income | **460** | 834 | –45% |
| Per Share, basic and diluted | **0.95** | 1.72 | |
| Dividends | **678** | 678 | 0% |
| Per Share | **1.40** | 1.40 | |
| **FINANCIAL RATIOS** | | | |
| Net debt-to-cash flow from operations (times)[1] | **1.7** | 0.6 | |
| Net debt-to-total net capitalization (%)[1] | **29** | 14 | |
| Return on average shareholders' equity (%)[1] | **10** | 18 | |
| Return on average productive capital employed (%)[1] | **10** | 18 | |
| **OPERATIONS** | | | |
| Sales volumes, net of crude oil purchases[2] | | | |
| Total (mmbbls) | **34.5** | 35.8 | –4% |
| Daily average (bbls) | **94,557** | 98,037 | |
| Operating expenses ($ millions) | **1,686** | 1,494 | 13% |
| Per barrel ($/bbl) | **48.86** | 41.75 | 17% |
| Capital expenditures ($ millions) | **930** | 1,342 | –31% |
| Realized Syncrude Crude Oil (SCO) selling price ($/bbl) | **99.24** | 99.55 | 0% |
| West Texas Intermediate (WTI) (average US$/bbl) | **92.91** | 98.05 | –5% |
| SCO discount to WTI (weighted average $/bbl) | **(2.55)** | (1.10) | |
| Foreign exchange rate (average US$/C$) | **0.91** | 0.97 | –6% |
| **SHARE INFORMATION** | | | |
| Closing price on December 31 ($/Share) | **10.42** | 19.98 | –48% |
| Number of shares outstanding (in millions) | **484.6** | 484.6 | 0% |
| Total shareholder return (%) | **–44** | 6 | |
| S&P/TSX Oil & Gas Index (%) | **–22** | 14 | |

1 Additional GAAP or Non-GAAP measure as defined in the Additional GAAP and Non-GAAP Financial Measures Advisory.
2 The Corporation's sales volumes differ from its production volumes due to changes in inventory, which are primarily in-transit pipeline volumes. Sales volumes are net of purchases.

# CHAIRMAN'S MESSAGE

Significant investments have been made at Syncrude over the past decade, and we must extract more value from that installed plant capacity. COS is aligned with Syncrude and its owners on the sense of urgency in this regard. Our aim is to enhance competitiveness through the full oil price and capital investment cycles.

Donald J. Lowry, Chairman of the Board

The past year marks Syncrude's 50th anniversary. As we reflect upon that important milestone, your Board has been assessing its progress in creating long-term value for COS shareholders, the largest owner of the Syncrude asset.

We acknowledge that 2014 shareholder returns were disappointing. While that performance is due in part to the dramatic decline in crude oil prices, Syncrude has not yet delivered expected improvements in operating performance. Your Board remains convinced that optimizing the Syncrude asset is the clearest path for creating value for COS shareholders. We are also focused on stewarding COS' risk management, financing, marketing and human resource strategies.

Improving Syncrude's production rates and controlling costs are fundamental to COS' strategy. Significant investments have been made at Syncrude over the past decade, and we must extract more value from that installed plant capacity. COS is aligned with Syncrude and its owners on the sense of urgency in this regard. Our aim is to enhance competitiveness through the full oil price and capital investment cycles.

We also must acknowledge the recent success achieved at Syncrude. In 2014, Syncrude achieved substantial completion of its approximately $8 billion major capital projects program under budget and on schedule. This investment in mining infrastructure and tailings management technology extends Syncrude's long-life production horizon and improves environmental performance.

In 2015, your Board is tasked with steering COS through a period of lower and more volatile crude oil prices. Our current focus is on protecting the financial strength of the company during this challenging time. While COS entered this period of lower crude oil prices with ample liquidity, maintaining balance sheet strength required early and meaningful dividend action. We appreciate that dividends are important to our shareholders, but preserving the long-term value of the business is the primary consideration.

The Board strongly believes that the interests of its members should be aligned with those of shareholders. A large component of Board compensation is in deferred share units, and we require Directors to hold three times the amount of their annual fees in shares or deferred share units. Similarly, total compensation for COS executives includes about 60 per cent that is at risk, reflecting their ability to influence business results and financial performance. Executives are required to hold a minimum level of common shares, which for the President

26

Canadian Oil Sands is among the best governed companies in Canada, ranking 26th among 247 companies in the S&P/TSX composite index for the quality of its governance practices, according to The Globe and Mail's "Report on Business Board Games 2014".

"We have the steadying force of a decades-long crude oil resource, major capital projects investment behind us and valuable infrastructure generating production today. We remain committed to the strategy of optimizing the performance of this asset."

Two of COS' directors have received the prestigious Fellowship Award from the Institute of Corporate Directors in recognition of their leadership in corporate governance.

For more information on COS' governance practices, see our management proxy circular at **www.cdnoilsands.com.**

and CEO is set at four times base compensation. These measures ensured that 2014 compensation reflected demonstrated performance and that the interests of management are strongly aligned with COS shareholders. Further details on our compensation practices are provided in our management proxy circular.

In 2014, COS made a number of improvements to its governance processes and policies. To highlight just a few, we adopted a Board retirement policy that considers both term and age limits; we considered diversity in our Board composition; and we are reducing our Board size from 11 to 10 members.

An important role the Board plays is in succession planning, and 2014 marked the first full year of leadership by our new President and CEO, Ryan Kubik. On behalf of the Board, I would like to thank Mr. Kubik and his team for their efforts over the past year.

I would also like to offer special acknowledgment to Mr. C.E. (Chuck) Shultz, our longest-serving board member and our prior Board Chair, who will be retiring at this year's annual general meeting. Mr. Shultz was instrumental in the formation of the original Canadian Oil Sands Trust and, over his long tenure with the company, COS has benefited greatly from his knowledge and insight.

Despite the current challenge of low crude oil prices, the Board views the Syncrude project as having tremendous value. We have the steadying force of a decades-long crude oil resource, major capital projects investment behind us and valuable infrastructure generating production today. We remain committed to the strategy of optimizing the performance of this asset.

On behalf of the Board, thank you for your support.

(signed)

**DONALD J. LOWRY**
Chairman of the Board
February 24, 2015

# PRESIDENT'S MESSAGE

On behalf of Canadian Oil Sands (COS) and our shareholders, I would like to congratulate Syncrude on 50 years of leadership. As a pioneer in the industry, Syncrude helped to demonstrate the commercial viability of the oil sands and to establish Canada as a globally significant energy provider.

Ryan Kubik, President and Chief Executive Officer

In 2014, Syncrude marked a milestone anniversary. The Syncrude joint venture was incorporated in 1964 to explore the commercial potential of Canada's oil sands, and produced its first barrel of upgraded oil in 1978. Syncrude has been in continuous production ever since.

Recognizing five decades in business is particularly pertinent today, as we enter another cycle of low crude oil prices. Syncrude has proven itself resilient in the past, able to overcome the challenges of developing a new hydrocarbon resource, compete with other sources of production and remain profitable throughout the oil price cycle. Continued success depends on an ability to respond to current challenges, and again, Syncrude is proving itself to be a leader.

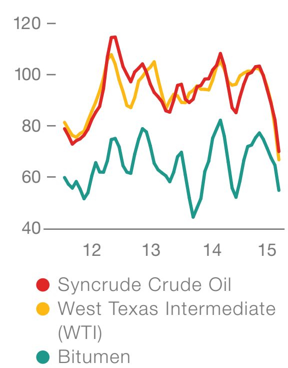
As a pure investment, Canadian Oil Sands' performance is inextricably linked to Syncrude and the price of oil. This has led to volatility in our share price and dividend payments. But it doesn't change our fundamental value – a long-term investment in a proven crude oil resource. While the current share price reflects the challenging business environment for energy companies today, it is not, in my view, representative of the value of our assets. Our Syncrude project represents decades of light, sweet crude oil, a commodity essential to modern life. At COS, we are taking action to protect our long-term value, and my letter will outline our steps in this regard.

## BALANCED, DECISIVE AND PRUDENT ACTION

COS was taking aim at Syncrude's costs well before the steep decline in crude oil prices in late 2014. We recognized that a lower cost structure is required for the long-term success of the business. This focus resulted in the creation of the Syncrude Cost Analysis and Strategy Taskforce last year to identify cost-reduction and cost-efficiency opportunities throughout the organization. Lower per barrel costs are also directly linked to our multi-year strategy for increasing production through improved capacity utilization. In today's business environment, we appreciate the urgency to pursue these critical initiatives.

While a fundamental approach to reducing the cost structure is underway, conserving cash becomes critical when oil prices are below breakeven points. In 2015, Syncrude has identified potential cost reductions of 10 to 15 per cent to be realized through a combination of spending cuts, spending deferrals and efficiencies from operating, development and capital expenditures. Reliability, safety and meeting regulatory commitments remain priorities. These cost reductions are not expected to affect

SYNCRUDE CRUDE OIL VS. WTI VS. BITUMEN PRICING
Trailing 3-month average ($US/bbl)



"Syncrude's aim of improving profitability is centred on achieving higher production and lower costs. I remain convinced that the approach being employed at Syncrude today under Imperial Oil and ExxonMobil's operating systems is our best opportunity to achieve these objectives."

Since 2001, Canadian Oil Sands has paid dividends totalling $7.8 billion.

Syncrude regularly achieves bitumen recovery rates exceeding 90%.

MEMBER OF
Dow Jones
Sustainability Indices
In Collaboration with RobecoSAM

Canadian Oil Sands has been included in the Dow Jones sustainability index since 2010.

production levels, and Canadian Oil Sands is maintaining its 2015 production outlook, which targets a nine per cent improvement over 2014.

COS has also taken action to conserve cash. In 2015, we reduced the quarterly dividend to $0.05 per Share from the previous $0.35 per Share. The new dividend is better aligned with current crude oil prices, and is a prudent measure to preserve our balance sheet strength and liquidity. Adjusting the dividend to reflect the business fundamentals is consistent with our strategy of paying out cash generated by the business while protecting the long-term value of your COS investment.

## IMPROVING PROFITABILITY

Syncrude's aim of improving profitability is centred on achieving higher production and lower costs. I remain convinced that the approach being employed at Syncrude today under Imperial Oil and ExxonMobil's operating systems is our best opportunity to achieve these objectives.

Under this approach, Syncrude has completed a number of significant improvements in mining, froth treatment and upgrading to address the root causes of previous unplanned outages. In both of Syncrude's operating mines, the primary bitumen mining facilities have been relocated and refurbished, or renewed entirely with new technology and infrastructure. In bitumen froth treatment, Syncrude retrofitted bitumen centrifuges to improve the quality of bitumen feed and increase throughput rates to the upgrader. And in upgrading, Syncrude replaced heat exchangers in its hydrogen plants. Additional goals to improve operations for 2015 are outlined on page nine of this report.

Syncrude is a highly complex and integrated facility, and progress in achieving better reliability and higher production has been slower than expected. In 2014, Syncrude produced 94.2 million barrels, well below the initial expectation of 105 million barrels. While mining and extraction showed an improvement over prior years, we experienced significant downtime in upgrading.

I believe there will come a point whereby enough constraints have been removed that we will begin to see our improvement efforts translate into higher production. Together with the other Syncrude owners, we remain committed to stewarding a disciplined, methodical approach to assure Syncrude's long-term success.

## AN INVESTMENT IN SYNCRUDE'S FUTURE

In 2014, Syncrude achieved substantial completion of its multi-year, multi-billion dollar major capital program. The approx-

## "Canadian Oil Sands will work with Syncrude and its owners to identify and optimize opportunities that ensure Syncrude continues its long history of oil sands leadership."

imately $8 billion investment is one of the largest in Syncrude's history, with the projects delivered on time and under budget. Only the Centrifuge Tailings Management project remains to be completed, and is on schedule to do so in 2015. The completion of this program positions Syncrude for decades of production, using existing infrastructure, and supports Syncrude's ability to deliver on its environmental commitments. Together with the Syncrude Emissions Reduction project, which commenced operation in 2013, these environmental projects are expected to significantly reduce air emissions and accelerate tailings treatment and land reclamation.

In 2014, Syncrude also took the first official step to secure its next stage of mining when it submitted a regulatory application for the Mildred Lake Extension (MLX) project. This project envisions developing pits adjacent to the existing operation, allowing Syncrude to further capitalize on existing mine infrastructure. The MLX project represents very compelling economics for securing new bitumen supply, enabling production from Mildred Lake for another decade. As well, the project will minimize land disturbance and eliminate the requirement for a new out-of-pit tailings facility. Project scoping is underway and, pending regulatory and Syncrude owner approval, capital investment and construction would begin late this decade.

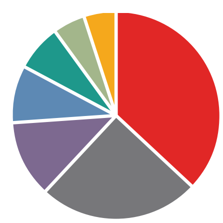
### UNLOCKING FUTURE OPPORTUNITIES

The MLX opportunity illuminates the potential value that exists across Syncrude's vast and rich lease position. Syncrude has a tremendous crude oil resource that extends across the heart of the Athabasca oil sands deposit. These high quality leases provide a foundation to grow or sustain production for many decades. In addition, Syncrude's current infrastructure offers additional capacity that can be unlocked to create value. Debottlenecking of the current assets and pursuing lease and mine optimization initiatives are all opportunities that may represent compelling economics – even with lower oil prices. Canadian Oil Sands will work with Syncrude and its owners to identify and optimize opportunities that ensure Syncrude continues its long history of oil sands leadership.

### A WORLD-CLASS ASSET

I wish to congratulate Syncrude on its remarkable history. Syncrude's journey and its achievements have had an impact far beyond its project gates. Syncrude crude oil provides the energy that millions of people use to power their lives; energy that makes them more comfortable, mobile and productive. This Canadian success story creates thousands of jobs and meaningful economic benefits across the country. Syncrude delivers these exceptional benefits with an unwavering commitment to employee health and safety, while meeting stringent

SYNCRUDE OWNERSHIP



- 36.74% Canadian Oil Sands
- 25% Imperial Oil
- 12% Suncor
- 9.03% Sinopec
- 7.23% Nexen (CNOOC)
- 5% Mocal
- 5% Murphy

## 2.5B

cumulative barrels of light, sweet crude oil produced at Syncrude

## 43Y

estimated proved and probable reserve life based on annual Syncrude production of 103 million barrels

## 15%

growth in global oil demand by 2040 (Source: International Energy Agency)

100% of Canadian Oil Sands' production is light, sweet crude oil.

Canadian Oil Sands offers the only pure investment opportunity in Syncrude.

For more information about Syncrude, visit **syncrude.ca.**

and ever-evolving expectations for environmental performance. As the largest owner in the joint venture, COS is proud to be part of this rich heritage.

I would like to thank Syncrude's many dedicated and hardworking employees, contractors and suppliers for contributing to the organization's success. Similarly, I extend my thanks to the team at COS, who are committed to unlocking Syncrude's full potential. During my first year as President and CEO, our Board of Directors has been a strong source of support and guidance, for which I am grateful. In particular, I would like to recognize the contributions of Mr. Chuck Shultz, who will be retiring in April of this year following 19 years of service with distinction on COS' Board, including almost 14 years as Chairman. His counsel over this time has been invaluable.

I believe the actions COS and Syncrude are taking secure a better future for your investment. Cost reduction and production initiatives underway at Syncrude should create a more competitive, profitable business. In addition, COS has taken steps to maintain a strong balance sheet and ample liquidity to endure an extended period of lower crude oil prices.

A global supply imbalance exists in the oil market today, but I fully expect crude oil prices to recover from current levels. Demand for crude oil continues to grow, as it is a fundamental source of energy required to improve the quality of life for many around the world. Higher prices are needed to attract investments to develop new sources of supply and offset inevitable global production declines. With our long-life reserves and installed processing infrastructure, COS is strongly positioned to meet growing crude oil demand. We look forward to sharing a more profitable future with you.

(signed)

**RYAN M. KUBIK**
President and Chief Executive Officer
February 24, 2015

# STRATEGIC SCORECARD

Canadian Oil Sands' strategy is focused on optimizing the value of the Syncrude asset. As a pure investment opportunity in Syncrude, we aim to deliver the potential benefit of long-life, light, sweet crude oil by not hedging production and prudently managing our balance sheet. COS is an active steward of our Syncrude interest, focused on improving operations and influencing the long-term vision for the business. Most recently, COS was instrumental in working with the Syncrude joint venture on the scope, schedule reviews and stewardship of the major projects capital program and participating in the development of the Mildred Lake Extension project.

In 2014, while we realized success on many of the objectives we set for that year, we did not achieve the one most important to us and our shareholders. Increasing production represents the best opportunity to enhance near-term value for shareholders. The specific goals for 2015 tied to improving reliability as well as reducing costs are provided on the right. In 2015, COS is also focused on protecting our balance sheet to manage our business through a lower crude oil price cycle.

## 2014 Objective #1

**Complete the Mildred Lake Mine Train Replacement project on time and on budget.**

- The new mine trains came into service in Q4 2014, on schedule.
- Completed at a cost of \$3.8 billion, \$400 million below the budget estimate of \$4.2 billion.
- Provides Syncrude with decades of strong, non-declining production.

## 2014 Objective #2

**Improve reliability over 2013, achieving production of 105 million barrels at Syncrude.**

- Syncrude production totalled 94.2 million barrels in 2014. The disappointing performance was due to unplanned outages in Syncrude's upgrading units.
- The two new mine trains at the Mildred Lake Mine have greater capacity and feature Syncrude patented high-recovery wet crushing technology; enhancements designed to support better reliability in bitumen production.
- Syncrude completed the retrofit of bitumen centrifuges, thereby improving the quality of bitumen feed and increasing throughput rates to the upgrader.
- Syncrude replaced the heat exchangers in its hydrogen plants, which should prevent production losses as a result of unplanned outages in those units.

2014
## Objective #3

Achieve 95% completion on the Centrifuge Tailings Management project.

- Project achieved 97% completion, and is on target to be completed in 2015.
- Tailings centrifuge is a key technology for Syncrude to meet Alberta tailings management regulation and is part of Syncrude's multi-pronged approach to managing tailings.
- Syncrude is sharing this technology through COSIA – an alliance of oil sands producers focused on improving environmental performance – to enable other operators to accelerate their performance in tailings management.

2014
## Objective #4

Maintain a strong balance sheet with a net debt level of $1 to $2 billion.

- Net debt was about $1.9 billion at December 31, 2014.
- Long-term debt-to-total capitalization was 30% at the end of 2014.
- COS has strong liquidity with access to a $1.5 billion credit facility, and no scheduled maturity on senior notes until 2019.

2014
## Objective #5

Submit application for approval of the Mildred Lake Extension (MLX) project.

- Syncrude submitted the application for MLX to the Alberta Energy Regulator in Q4 2014.
- MLX is a highly economic project that enables Syncrude to capitalize on the recent investment of the Mildred Lake Mine Train Replacement project.
- MLX extends the life of the Mildred Lake Mine to the mid 2030s, providing a strong and stable source of bitumen for more than a decade.

2015
## Goals for this year

- **Preserve COS balance sheet strength and financial flexibility.**
- **Achieve Syncrude production of 95 to 110 million barrels (35 to 40 million barrels net to COS).**
- **Deliver targeted cost reductions and improve profitability at the Syncrude operation.**
- **Fully commission the new Mildred Lake Mine trains and demonstrate designed production rates.**
- **Implement design improvements in two of Syncrude's CO boilers to reduce coker downtime.**
- **Modify the Flue Gas Desulphurizer (FGD) to improve its processing efficiency and coker throughput.**

# SHAREHOLDER INFORMATION

## BOARD OF DIRECTORS

**DONALD J. LOWRY**
Chairman of the Board
Edmonton, Alberta

**IAN A. BOURNE**[1,2]
Calgary, Alberta

**GERALD W. GRANDEY**[1,2]
Saskatoon, Saskatchewan

**ARTHUR N. KORPACH**[2,3]
Calgary, Alberta

**RYAN M. KUBIK**
Calgary, Alberta

**SARAH E. RAISS**[1]
Calgary, Alberta

**JOHN K. READ**[3]
Calgary, Alberta

**BRANT G. SANGSTER**[3]
Calgary, Alberta

**C.E. (CHUCK) SHULTZ**[3]
Calgary, Alberta

**WESLEY R. TWISS**[2,3]
Calgary, Alberta

**JOHN B. ZAOZIRNY, Q.C.**[1]
Calgary, Alberta

1 Member of the Corporate Governance and Compensation Committee

2 Member of the Audit Committee

3 Member of the Reserves, Marketing Operations and Environmental, Health and Safety Committee

## LEADERSHIP TEAM

**RYAN M. KUBIK**
President and Chief Executive Officer

**ROBERT P. DAWSON**
Chief Financial Officer

**TRUDY M. CURRAN**
Senior Vice President, General Counsel and Corporate Secretary

**DARREN K. HARDY**
Senior Vice President, Operations

**DAVID J. SIRRS**
Vice President, Marketing

**SIREN FISEKCI**
Vice President, Investor and Corporate Relations

**SCOTT T. GREENSHIELDS**
Vice President, Tax, Controller and Special Projects

**ADRIENNE NICKERSON**
Vice President, Operations

**PHILIP D. BIRKBY**
Treasurer

**SCOTT W. ARNOLD**
Director, Investor and Corporate Relations

## TICKER SYMBOLS

Toronto Stock Exchange: COS
OTCQX: COSWF

## REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada, with offices in Vancouver, Calgary, Toronto and Montreal, is the registrar and Transfer Agent for Canadian Oil Sands Limited

## COMPUTERSHARE TRUST COMPANY OF CANADA

600, 530 – 8th Avenue S.W.
Calgary, Alberta T2P 3S8
Telephone: 1 (800) 564-6253
Fax: (403) 267-6598
Email: service@computershare.com

## AUDITORS

**PRICEWATERHOUSECOOPERS LLP**
Calgary, Alberta

## INDEPENDENT QUALIFIED RESERVES EVALUATORS

**GLJ PETROLEUM CONSULTANTS LTD.**
Calgary, Alberta

## INTERNAL AUDITORS

**DELOITTE & TOUCHE LLP**
Calgary, Alberta

## CANADIAN OIL SANDS LIMITED

2000 First Canadian Centre
350 – 7th Avenue S.W.
Calgary, Alberta T2P 3N9
Telephone: (403) 218-6200
Fax: (403) 218-6201

## INVESTOR AND MEDIA CONTACTS

**SIREN FISEKCI**
Vice President, Investor and Corporate Relations

**SCOTT W. ARNOLD**
Director, Investor and Corporate Relations

**TELEPHONE: (403) 218-6220**
Email: invest@cdnoilsands.com

Connect with us online and check out our blog at: **http://blog.cdnoilsands.com**

# ADVISORY INFORMATION

## FORWARD-LOOKING INFORMATION

In the interest of providing the shareholders and potential investors of Canadian Oil Sands Limited (the "Corporation") with information regarding the Corporation, including management's assessment of the Corporation's future production and cost estimates, plans and Syncrude operations, certain statements throughout this annual report contain forward-looking information and forward-looking statements (collectively referred to as "forward-looking statements") under applicable securities law. Forward-looking statements are typically identified by words such as "anticipate", "expect", "believe", "plan", "intend" or similar words suggesting future outcomes.

Forward-looking statements in this annual report include, but are not limited to, statements with respect to: the 2015 annual Syncrude production range of 95 million barrels to 110 million barrels and the Corporation's 2015 budget assumption of 103 million barrels (37.8 million barrels net to the Corporation); the estimated potential 2015 cost reductions in operating and development expenses and capital expenditures identified through Syncrude's cost review and the belief that the cost reductions will not affect reliability, safety, regulatory commitments or production; all expectations regarding dividends; the belief that the major tailings managements projects and the Syncrude Emissions Reduction project should significantly reduce air emissions and accelerate tailings treatment and land reclamation; the belief that the Mildred Lake Extension ("MLX") project should extend the life of mining operations at the Mildred Lake mine by about a decade; the expectations regarding the timing of capital investment and construction for the MLX project; all views regarding crude oil prices; the estimated amount of reserves recoverable and the timeframe to recover such reserves; the target completion date for the centrifuge plant at the Mildred Lake mine; the expectations regarding the commissioning of the Mildred Lake mine train replacements; the expectations regarding the design improvements in Syncrude's CO boilers; and the expectations regarding the improvements to the Flue Gas Desulphurizer.

You are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur. Although the Corporation believes that the expectations represented by such forward-looking statements are reasonable and reflect the current views of the Corporation with respect to future events, there can be no assurance that such assumptions and expectations will prove to be correct.

The factors or assumptions on which the forward-looking statements are based include, but are not limited to: the assumptions outlined in the Corporation's guidance document as posted on the Corporation's website at **www.cdnoilsands.com** as of January 29, 2015 and as subsequently amended or replaced from time to time, including without limitation, the assumptions as to production, operating expenses and oil prices; the successful and timely implementation of capital projects; Syncrude's major project spending plans; the ability to obtain regulatory and Syncrude joint venture owner approval; our ability to either generate sufficient cash flow from operations to meet our current and future obligations or obtain external sources of debt and equity capital; the continuation of assumed tax, royalty and regulatory regimes and the accuracy of the estimates of our reserves and resources volumes.

Some of the risks and other factors which could cause actual results or events to differ materially from current expectations expressed in the forward-looking statements contained in this annual report include, but are not limited to: volatility of crude oil prices; volatility of the Syncrude crude oil ("SCO") to West Texas Intermediate differential; the impact that pipeline capacity and apportionment and refinery demand have on prices for SCO and the ability to deliver SCO; the impacts of regulatory changes especially those which relate to royalties, taxation, tailings, water and the environment; the impact of new technologies on the cost of oil sands mining; the impacts of rising costs associated with tailings and water management; the inability of Syncrude to obtain required consents, permits or approvals, including without limitation, the inability of Syncrude to obtain approval to return water from its operations; the impact of Syncrude being unable to meet the conditions of its approval for its tailings management plan under Directive 074; various events which could disrupt operations including fires, equipment failures and severe weather; unsuccessful or untimely implementation of capital or maintenance projects; the impact of technology on operations and processes and how new complex technology may not perform as expected; the obtaining of required owner approvals from the Syncrude owners for expansions, operational issues and contractual issues; labour turnover and shortages and the productivity achieved from labour in the Fort McMurray area; uncertainty of estimates with respect to reserves and resources; the supply and demand metrics for oil and natural gas; currency and interest rate fluctuations; volatility of natural gas prices; the Corporation's ability to either generate sufficient cash flow from operations to meet its current and future obligations or obtain external sources of debt and equity capital; the inability of the Corporation to continue to meet the listing requirements of the Toronto Stock Exchange; general economic, business and market conditions and such other risks and uncertainties described in the Corporation's annual information form dated February 24, 2015 and in the reports and filings made with securities regulatory authorities from time to time by the Corporation which are available on the Corporation's profile on SEDAR at **www.sedar.com** and on the Corporation's website at **www.cdnoilsands.com.**

You are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this annual report are made as of February 24, 2015, and unless required by law, the Corporation does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this annual report are expressly qualified by this cautionary statement.

## ADDITIONAL GAAP AND NON-GAAP FINANCIAL MEASURES

In this annual report, we refer to financial measures that do not have any standardized meaning as prescribed by Canadian GAAP. These financial measures include additional GAAP financial measures (which are line items, headings or subtotals in the financial statements that are not mandated by Canadian GAAP, and other financial measures that are disclosed in the notes to the financial statements) and non-GAAP financial measures (which are additional financial measures that are not presented within the financial statements). These measures have been described and presented in order to provide shareholders and potential investors with additional measures for analyzing our ability to generate funds to finance our operations and information regarding our liquidity. Users are cautioned that additional GAAP and non-GAAP financial measures presented by the Corporation may not be comparable with measures provided by other entities.

Additional GAAP financial measures include: cash flow from operations (which is calculated as cash from operating activities before changes in non-cash working capital); cash flow from operations per Share (which is calculated as cash flow from operations divided by the weighted-average number of shares outstanding in the period); and net debt-to-total net capitalization (which is calculated as net debt, comprised of long-term debt less cash and cash equivalents, divided by net debt plus shareholders' equity).

Non-GAAP financial measures include: net debt-to-cash flow from operations (which is calculated as net debt, comprised of long-term debt less cash and cash equivalents, divided by cash from operating activities before changes in non-cash working capital); return on average productive capital employed (which is calculated as net income before the after-tax impacts of interest expense on long-term debt (net of interest income) and foreign exchange gains and losses on long-term debt, divided by average net debt plus shareholders' equity, less capitalized costs related to major expansion projects not yet in use); return on average shareholders' equity (which is calculated as net income divided by average shareholders' equity outstanding during the year); and free cash flow (which is calculated as cash from operating activities before changes in non-cash working capital less capital expenditures).

For more information on additional GAAP financial measures please refer to our 2014 annual MD&A.

## RESERVE DEFINITIONS

**Proved plus probable reserves:** Additional reserves that are less certain to be recovered than proved reserves. NI 51-101 defines the certainty level as "at least a 50% probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves". Therefore, under NI 51-101, the proved plus probable reserves represent a "best estimate" or "expected reserves".

**Proved reserves:** Reserves that can be estimated with a high degree of certainty to be recoverable. NI 51-101 further identifies the certainty level for proved reserves as "at least a 90% probability that the quantities actually recovered will equal or exceed the estimated proved reserves".

## ABBREVIATIONS

**barrel(s):** bbl, bbls

**millions of barrels:** mmbbls

**Syncrude crude oil:** SCO

**thousands of barrels:** mbbls

**West Texas Intermediate:** WTI

# WHY INVEST IN COS?

## Superior Quality

With large, bitumen-rich leases located in the sweet spot of the Athabasca oil sands deposit and a fully integrated upgrading facility that produces 100% light, sweet crude oil, the quality of our Syncrude asset is exceptional.

## Experienced

Syncrude is an experienced oil sands operator. Its track record is bolstered by the expertise of Imperial Oil and ExxonMobil to support improving operational performance and project expansion into the future.

## Dependable

Syncrude's high-quality crude oil resource provides a solid, long-life cash generating asset base. Canadian Oil Sands strives to protect the long-term value of our Syncrude asset through efficient capital management and a strong balance sheet.

## Innovative

Syncrude is committed to a world-class research and development program and active collaboration with third parties. Syncrude has invented many of the technologies that are now standard in the industry. That focus on innovation will enable Syncrude to evolve new and better ways to produce oil from the sands while developing and sharing technologies to create environmental solutions.

## Essential

Crude oil will continue to be a major source of energy for the world, fueling global progress and prosperity for decades into the future. Canada's oil sands are a significant, growing and secure source of supply. Canada's ability to deliver its product safely, reliably and with a commitment to environmental stewardship make it a preferred supplier of energy to the world.

# 50 YEARS OF LEADERSHIP

## 1964
Syncrude Canada Ltd. is incorporated.

## 1978
Syncrude Project officially opens and produces its first barrel of upgraded crude oil.

## 1984
Syncrude introduces naphtha recovery technology into its extraction operations, enhancing economic and environmental performance.

## 1988
Technology advancements continue as research scientists design a key element in the development of hydro-transport technology – a cyclo-reactor, shaped like a cyclone, to get oil sands into a pipeline.

## 1997
Syncrude introduces the first full-scale commercial application of its hydrotransport technology, thereby improving energy efficiency and enabling mining of remote oil sands sites.

## 1999
The Vacuum Distillation Unit comes into operation, boosting Syncrude's production capacity and energy efficiency.

## 2000
Syncrude opens the Aurora North Mine and introduces its low energy extraction technology.

## 2002
GOLD

The Canadian Council for Aboriginal Business honours Syncrude for the first time with Gold Level status in the Progressive Aboriginal Relations (PAR) Program, recognizing its leadership and demonstrated commitment to working with Aboriginal people in the community.

## 2006
Stage 3 expansion completed at a cost of $8.5 billion and includes construction of a third fluid coker, a mine train at the Aurora North Mine and further improvement to product quality.

Syncrude and Imperial Oil enter into a Management Services Agreement, providing Syncrude with access to Imperial Oil and ExxonMobil's global best practices, systems and expertise to improve operational reliability.

## 2008
Syncrude received the industry's first government certification for reclaimed land, demonstrating success in returning land to a self-sustaining ecosystem and habitat capability.

## 2012
Syncrude joins other oil sands producers to form the Canadian Oil Sands Innovation Alliance (COSIA) aimed at accelerating innovation in environmental performance.

## 2013
The cumulative total for Syncrude procurement with Aboriginal-owned companies surpasses $2 billion.

## 2014
1964 50 Syncrude 2014

Syncrude completes an approximately $8 billion capital investment program to support decades of future production and accelerate mine tails reclamation.

Syncrude cumulative production surpasses 2.5 billion barrels.

DESIGN: CRAIB DESIGN AND COMMUNICATIONS WWW.CRAIB.COM









Canadian Oil Sands

CDNOILSANDS.COM

Connect with us online and check out our blog at: http://blog.cdnoilsands.com

Canadian Oil Sands

2014 ANNUAL REPORT

# FINANCIAL REPORT

CONTENTS

# Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") was prepared as of February 24, 2015 and should be read in conjunction with the audited consolidated financial statements and notes thereto of Canadian Oil Sands Limited (the "Corporation") for the years ended December 31, 2014 and December 31, 2013 and the Corporation's Annual Information Form ("AIF") dated February 24, 2015. Additional information on the Corporation, including its AIF, is available on SEDAR at **www.sedar.com** or on the Corporation's website at **www.cdnoilsands.com.** References to "Canadian Oil Sands", "COS" or "we" include the Corporation, its subsidiaries and partnerships. The financial results of Canadian Oil Sands have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and are reported in Canadian dollars, unless stated otherwise.

## Advisories

### Forward-Looking Information

*In the interest of providing the Corporation's shareholders and potential investors with information regarding the Corporation, including management's assessment of the Corporation's future production and cost estimates, plans and Syncrude operations, certain statements throughout this MD&A contain forward-looking information and forward-looking statements (collectively referred to as "forward-looking statements") under applicable securities law. Forward-looking statements are typically identified by words such as "anticipate", "expect", "believe", "plan", "intend" or similar words suggesting future outcomes.*

*Forward-looking statements in this MD&A include, but are not limited to, statements with respect to: the estimated value and amount of reserves and resources recoverable and the time frame to recover such reserves and resources; the 2015 annual Syncrude production range of 95 million barrels to 110 million barrels and the Corporation's 2015 Budget assumption of 103 million barrels (37.8 million barrels net to the Corporation); plans regarding crude oil and currency hedges; the estimated potential 2015 cost reductions in operating, development and capital costs identified through Syncrude's cost review and the belief that the cost reductions will not impact health and safety, production or reliability initiatives; the estimated cost and completion date for the centrifuge plant at the Mildred Lake mine; the belief that the investment in the Syncrude major projects provides Syncrude with the infrastructure to produce the remaining ore at its two operating mines and improve its tailings management performance, as well as support new ore production from its Mildred Lake Extension ("MLX") project once approved; the belief that the MLX project should extend the life of the Mildred Lake operations by approximately 10 years; the timing of capital investment and construction for the MLX project; the belief that fluctuations in the Corporation's realized selling prices, U.S. to Canadian dollar exchange rate fluctuations, planned and unplanned maintenance activities, environmental and tailings management activities to meet regulatory requirements, changes in bitumen values and changes in natural gas prices may impact the Corporation's financial results in the future; the belief that future depreciation and depletion expense will increase upon completion of the Syncrude major capital projects; all expectations regarding dividends, including the establishment of future dividend levels with the intent of absorbing short-term market volatility over several quarters; the belief that, based on the assumptions in our 2015 Outlook, the Corporation will have sufficient cash flow from operations to fund its December 31, 2014 working capital deficiency; the expectations regarding where the Corporation's synthetic crude oil ("SCO") will be consumed in the future; the factors that may impact the realized selling price that the Corporation receives for SCO; the estimated sales, operating expenses, purchased energy costs, development expenses, Crown royalties, current taxes, capital expenditures and cash flow from operations for 2015; the estimated price for crude oil and natural gas in 2015; the estimated foreign exchange rates in 2015; the estimated realized selling price, which includes the anticipated differential to West Texas Intermediate ("WTI") to be received in 2015 for the Corporation's product; the expectations regarding net debt; the estimated 2015 regular maintenance, capitalized interest and major project spending; the anticipated impact of increases or decreases in oil prices, production, operating expenses, foreign exchange rates and natural gas prices on the Corporation's cash flow from operations; the timing of the turnaround of Coker 8-3; the belief that the Mildred Lake mine train replacements should increase processing capacity, improve reliability and reduce maintenance costs; and the belief that the centrifuge plant at the Mildred Lake mine should accelerate the pace of tailings treatment to meet regulatory requirements.*

*You are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur. Although the Corporation believes that the expectations represented by such forward-looking statements are reasonable and reflect the current views of the Corporation with respect to future events, there can be no assurance that such assumptions and expectations will prove to be correct.*

*The factors or assumptions on which the forward-looking statements are based include, but are not limited to: the assumptions outlined in the Corporation's guidance document as posted on the Corporation's website at **www.cdnoilsands.com** as of January 29, 2015 and as subsequently amended or replaced from time to time, including without limitation, the assumptions as to production, operating expenses and oil prices; the successful and timely implementation of capital projects; Syncrude's major project spending plans; the ability to obtain regulatory and Syncrude joint venture owner approval; our ability to either generate sufficient cash flow from operations to meet our current and future obligations or obtain external sources of debt and equity capital; the continuation of assumed tax, royalty and regulatory regimes and the accuracy of the estimates of our reserves and resources volumes.*

*Some of the risks and other factors which could cause actual results or events to differ materially from current expectations expressed in the forward-looking statements contained in this MD&A include, but are not limited to: volatility of crude oil prices; volatility of the SCO to WTI differential; the impact that pipeline capacity, apportionment and refinery demand have on prices for SCO and the ability to deliver SCO; the impacts of regulatory changes especially those which relate to royalties, taxation, tailings, water and the environment; the impact of new technologies on the cost of oil sands mining; the impacts of rising costs associated with tailings and water management; the inability of Syncrude to obtain required consents, permits or approvals, including without limitation, the inability of Syncrude to obtain approval to return water from its operations; the impact of Syncrude being unable to meet the conditions of its approval for its tailings management plan under Directive 074; various events which could disrupt operations including fires, equipment failures and severe weather; unsuccessful or untimely implementation of capital or maintenance projects; the impact of technology on operations and processes and how new complex technology may not perform as expected; the obtaining of required owner approvals from the Syncrude owners for expansions, operational issues and contractual issues; labour turnover and shortages and the productivity achieved from labour in the Fort McMurray area; uncertainty of estimates with respect to reserves and resources; the supply and demand metrics for oil and natural gas; currency and interest rate fluctuations; volatility of natural gas prices; the Corporation's ability to either generate sufficient cash flow from operations to meet its current and future obligations or obtain external sources of debt and equity capital; the inability of the Corporation to continue to meet the listing requirements of the Toronto Stock Exchange; general economic, business and market conditions and such other risks and uncertainties described in the Corporation's AIF dated February 24, 2015 and in the reports and filings made with securities regulatory authorities from time to time by the Corporation which are available on the Corporation's profile on SEDAR at **www.sedar.com** and on the Corporation's website at **www.cdnoilsands.com**.*

*You are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of February 24, 2015, and unless required by law, the Corporation does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.*

**Additional GAAP Financial Measures**

*In this MD&A, we refer to additional GAAP financial measures that do not have any standardized meaning as prescribed by Canadian GAAP. Additional GAAP financial measures are line items, headings or subtotals in addition to those required under Canadian GAAP, and financial measures disclosed in the notes to the financial statements which are relevant to an understanding of the financial statements and are not presented elsewhere in the financial statements. These measures have been described and presented in order to provide shareholders and potential investors with additional measures for analyzing our ability to generate funds to finance our operations and information regarding our liquidity. Users are cautioned that additional GAAP financial measures presented by the Corporation may not be comparable with measures provided by other entities.*

*Additional GAAP financial measures include: cash flow from operations, cash flow from operations per Share, net debt, total net capitalization, total capitalization, net debt-to-total net capitalization and long-term debt-to-total capitalization.*

*Cash flow from operations is calculated as cash from operating activities before changes in non-cash working capital. Cash flow from operations per Share is calculated as cash flow from operations divided by the weighted-average number of Shares outstanding in the period. Because cash flow from operations and cash flow from operations per Share are not impacted by fluctuations in non-cash working capital balances, we believe these measures are more indicative of operational performance than cash from operating activities. With the exception of current taxes, liabilities for Crown royalties and the current portion of our asset retirement obligation, our non-cash working capital is liquid and typically settles within 30 days.*

*Cash flow from operations is reconciled to cash from operating activities as follows:*

| *($ millions)* | | 2014 | | 2013 |
|---|---|---|---|---|
| Cash flow from operations[1] | $ | 1,106 | $ | 1,347 |
| Change in non-cash working capital[1] | | (361) | | 236 |
| Cash from operating activities[1] | $ | 745 | $ | 1,583 |

*[1] As reported in the Consolidated Statements of Cash Flows.*

*Net debt, total net capitalization, total capitalization, net debt-to-total net capitalization and long-term debt-to-total capitalization are used by the Corporation to analyze liquidity and manage capital, as discussed in the "Liquidity and Capital Resources" section of this MD&A and in Note 17 to the consolidated financial statements for the years ended December 31, 2014 and December 31, 2013.*

## Business Description

Canadian Oil Sands is the largest owner of the Syncrude Joint Venture ("Syncrude"), a major producer of high quality, low sulphur, light, synthetic crude oil ("SCO"). Canadian Oil Sands' only producing asset is its 36.74 per cent working interest in Syncrude, generating revenue from its share of production. COS represents the only public opportunity for undiversified investment directly in Syncrude.

Syncrude is involved in the mining and upgrading of bitumen from oil sands near Fort McMurray in northern Alberta. The Syncrude Project is comprised of open-pit oil sands mines, utilities plants, bitumen extraction plants and an upgrading complex that processes bitumen into SCO. Syncrude is jointly controlled by seven owners. Each owner has an undivided interest in the assets of Syncrude, takes its production in kind, and funds its proportionate share of Syncrude's operating, development and capital costs on a daily basis. Canadian Oil Sands also owns 36.74 per cent of the issued and outstanding shares of Syncrude Canada Ltd. ("Syncrude Canada"). Syncrude Canada operates Syncrude on behalf of the owners and is responsible for selecting, compensating, directing and controlling Syncrude's employees, and for administering all related employment benefits and obligations. Oversight of Syncrude Canada is provided by a Syncrude Management Committee and various management sub-committees as well as Syncrude Canada's Board of Directors and Board committees, all of which are staffed by representatives of the Syncrude owners. In particular, the Syncrude Management Committee oversees and approves significant Syncrude expenditures and long-term strategies.

Syncrude's leases are located in the Athabasca oil sands deposit. Syncrude's reserves and resources are all considered to be recoverable through surface mining, meaning that the oil sands are found beneath a relatively shallow overburden layer. Based on evaluations performed in accordance with the Canadian Oil and Gas Evaluation ("COGE") Handbook by our qualified independent petroleum reserve evaluators effective December 31, 2014, Canadian Oil Sands estimates Syncrude's proved plus probable reserves at 4.4 billion barrels (1.6 billion barrels net to the Corporation), best-estimate contingent resources at 4.6 billion barrels (1.7 billion barrels net to the Corporation) and best-estimate prospective resources at 1.1 billion barrels (0.4 billion barrels net to the Corporation) of SCO. Based on the 2015 Outlook of estimated production between 95 million and 110 million barrels for the year, Syncrude's proved plus probable reserve life is estimated to be between 40 and 46 years. More information regarding Canadian Oil Sands' reserves and resources can be found in the "Reserves Data and Other Information" section in our AIF dated February 24, 2015, which can be found at **www.sedar.com** or on our website at **www.cdnoilsands.com**.

Syncrude produces SCO by mining oil sands, extracting the bitumen from the sands, upgrading the recovered bitumen into lighter oil fractions and combining those fractions into a single SCO product. Using proven open-pit mining technologies to access the oil sands deposits results in a recovery rate of 90 per cent or more of the bitumen in place. As a large, integrated facility, production volumes reflect the capacity of the facility and the reliability of Syncrude's operations. Because a large portion of the operating costs do not vary with production, the aim is to maximize throughput in a safe and sustainable manner in order to increase production volumes and reduce per-barrel costs. While regular maintenance of operating units is required, unplanned outages of units do occur and these outages usually result in additional maintenance or repair costs and reduced production volumes, ultimately impacting revenues and operating expenses. Over the past five years, Syncrude's production has averaged about 279,000 barrels per day. Syncrude's operations are subject to a number of risks that are discussed in further detail in the "Risk Management" section of this MD&A.

Canadian Oil Sands' cash flow from operations and net income are dependent on the selling price received for SCO, sales volumes, operating and other expenses, including Crown royalties and income taxes. The dividends paid to Shareholders are also dependent on these factors, the amount and timing of capital expenditures and the level of net debt. The price we receive for our SCO, net of crude oil purchases and transportation expense, reflects the realized selling price at the Syncrude plant gate. Historically, our annual average selling price has correlated closely with the West Texas Intermediate ("WTI") benchmark oil price and has been impacted by movements in United States/Canadian ("U.S./Cdn") currency exchange rates. However, changes to supply and demand fundamentals also create volatility in crude oil prices and impact the price differential of our SCO product relative to Canadian dollar WTI as well as WTI prices relative to other crude oil benchmarks. These price differentials can change quickly, reflecting changes in the short-term supply and demand in the market and the availability of pipelines and other delivery capacity for transporting crude oil. Canadian Oil Sands prefers to remain unhedged on crude oil prices; however, during periods of significant capital spending and financing requirements, the Corporation may hedge prices to reduce cash flow volatility.

## Overview

Canadian Oil Sands Limited ("COS") generated cash flow from operations of $1,106 million ($2.28 per Share) in 2014 compared with $1,347 million ($2.78 per Share) in 2013. The decrease of $241 million largely reflects higher operating expenses and lower sales volumes, partially offset by lower current taxes.

Operating expenses in 2014 were $1.7 billion, compared with $1.5 billion in 2013, due to additional maintenance costs associated with unplanned outages on upgrading units, higher drilling and tailings management activities, and higher natural gas prices.

Syncrude produced 94.2 million barrels, or 258,100 barrels per day, in 2014 compared with 97.5 million barrels, or 267,000 barrels per day, in 2013. Production in 2014 was reduced by unplanned outages on Coker 8-1, sulphur processing units and a sour water treatment unit, whereas in 2013, delays completing scheduled turnarounds as well as unplanned outages in extraction units impacted production.

Syncrude is following a disciplined, methodical approach to addressing the root causes of unplanned outages with several initiatives completed in 2014 and more planned for 2015. We expect 2015 production to range from 95 to 110 million barrels with a single-point estimate of 103 million barrels.

COS' realized SCO selling price was similar in 2014 to 2013; however, the sharp decline in crude oil prices that began in the last quarter of 2014 continued into 2015 with West Texas Intermediate ("WTI") averaging US$93 per barrel in 2014 compared to US$73 per barrel in the fourth quarter of 2014 and US$47 per barrel in January 2015.

In response to the price environment, Syncrude is undertaking a comprehensive review of costs. An effort was underway at Syncrude to reduce the cost structure, but this work has intensified to identify near-term opportunities. The initial efforts have identified potential cost reductions in 2015, net to COS, of $260 million to $400 million, or about 10 to 15 per cent, in operating, development and capital costs, of which $294 million, net to COS, of these potential cost reductions is incorporated in COS' 2015 Outlook. Syncrude does not anticipate these reductions to have an impact on health and safety, production or reliability initiatives.

During 2014 and early 2015, there has been a significant weakening of the Canadian dollar, which mitigated the impact of the drop in oil prices. It also resulted in an unrealized foreign exchange loss on U.S. dollar denominated long-term debt.

To preserve balance sheet strength in the short and medium term, COS reduced its quarterly dividend to $0.05 per Share for the first quarter of 2015. COS is in a strong financial position with net debt of approximately $1.9 billion at December 31, 2014, representing long-term debt-to-total capitalization of 30 per cent. With a long-term debt-to-total capitalization covenant of 55 per cent, a significant increase in debt or decrease in equity would be required to negatively impact our financial flexibility.

Progress on Syncrude's major projects continued in 2014 with the new Mildred Lake mine trains commencing operations in the fourth quarter of 2014 and completion of the Centrifuge Tailings Management project expected in 2015. With the completion of these major projects, the financing and execution risk of Syncrude's major capital program is largely behind us. The investment in this program provides Syncrude with the infrastructure to produce the remaining ore at its two operating mines and improve its tailings management performance, as well as support new ore production from its Mildred Lake Extension ("MLX") project once approved.

Syncrude filed an application for regulatory approval of its MLX project in December 2014. If approved, this project is intended to extend the life of Syncrude's Mildred Lake mine operations by approximately 10 years. Project scoping is underway and a cost estimate has not yet been approved by Syncrude's owners. Pending regulatory approval, capital investment and construction would begin later this decade.

## Highlights

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Cash flow from operations[1] ($ millions) | **$ 1,106** | $ 1,347 | $ 1,581 |
| Per Share[1] ($/Share) | **$ 2.28** | $ 2.78 | $ 3.26 |
| Net income ($ millions) | **$ 460** | $ 834 | $ 973 |
| Per Share, Basic and Diluted ($/Share) | **$ 0.95** | $ 1.72 | $ 2.01 |
| Sales volumes[2] | | | |
| Total (mmbbls) | **34.5** | 35.8 | 38.7 |
| Daily average (bbls) | **94,557** | 98,037 | 105,680 |
| Realized SCO selling price ($/bbl) | **$ 99.24** | $ 99.55 | $ 91.90 |
| West Texas Intermediate ("WTI") (average $US/bbl) | **$ 92.91** | $ 98.05 | $ 94.15 |
| SCO premium (discount) to WTI (weighted average $/bbl) | **$ (2.55)** | $ (1.10) | $ (2.42) |
| Average foreign exchange rate ($US/$Cdn) | **$ 0.91** | $ 0.97 | $ 1.00 |
| Operating expenses ($ millions) | **$ 1,686** | $ 1,494 | $ 1,505 |
| Per barrel ($/bbl) | **$ 48.86** | $ 41.75 | $ 38.91 |
| Capital expenditures ($ millions) | **$ 930** | $ 1,342 | $ 1,086 |
| Dividends ($ millions) | **$ 678** | $ 678 | $ 654 |
| Per Share ($/Share) | **$ 1.40** | $ 1.40 | $ 1.35 |
| Total assets | **$ 10,014** | $ 10,190 | $ 10,171 |
| Net debt[3] | **$ 1,856** | $ 796 | $ 241 |
| Total other long-term liabilities[4] | **$ 1,594** | $ 1,194 | $ 1,509 |

*[1] Cash flow from operations and cash flow from operations per Share are additional GAAP financial measures and are defined in the "Additional GAAP Financial Measures" section of this MD&A.*

*[2] The Corporation's sales volumes differ from its production volumes due to changes in inventory, which are primarily in-transit pipeline volumes. Sales volumes are net of purchases.*

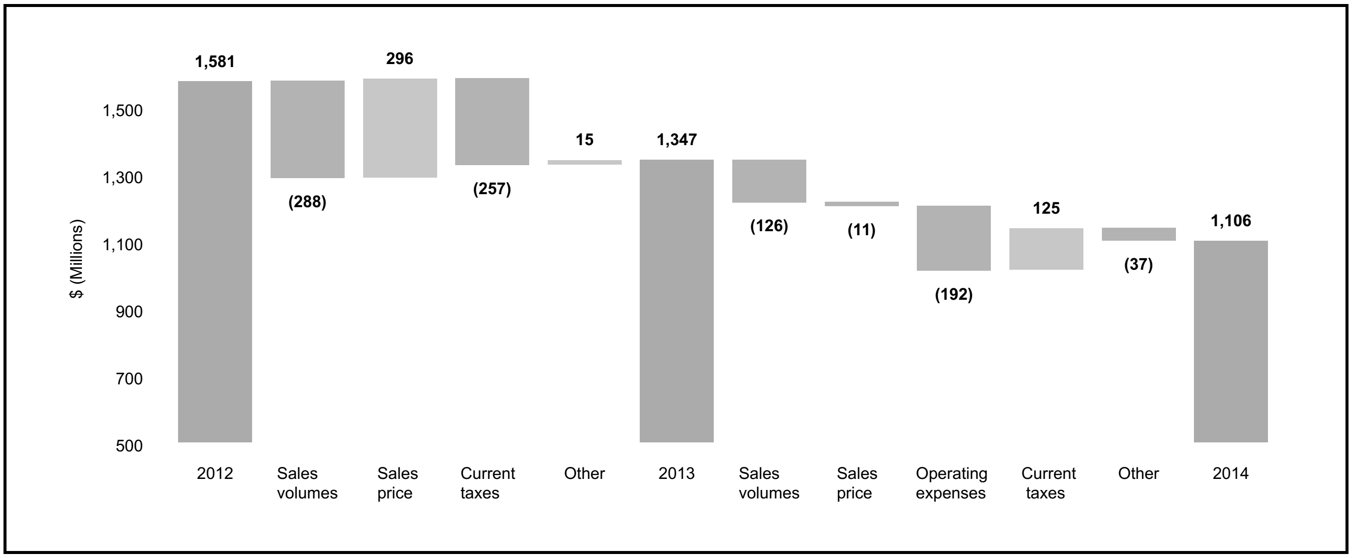
*[3] Long-term debt less cash and cash equivalents. Net debt is an additional GAAP financial measure and is defined in the "Liquidity and Capital Resources" section of this MD&A.*

*[4] Includes non-current portions of employee future benefits, Crown royalties and the asset retirement obligation.*

## Review of Financial Results

*Canadian Oil Sands' unaudited fourth quarter 2014 results were discussed and analyzed in our MD&A released on January 29, 2015, which is incorporated by reference into this MD&A and is available on our website at **www.cdnoilsands.com** or at **www.sedar.com**. The 2014 results presented in this MD&A dated February 24, 2015 are unchanged from the MD&A dated January 29, 2015.*

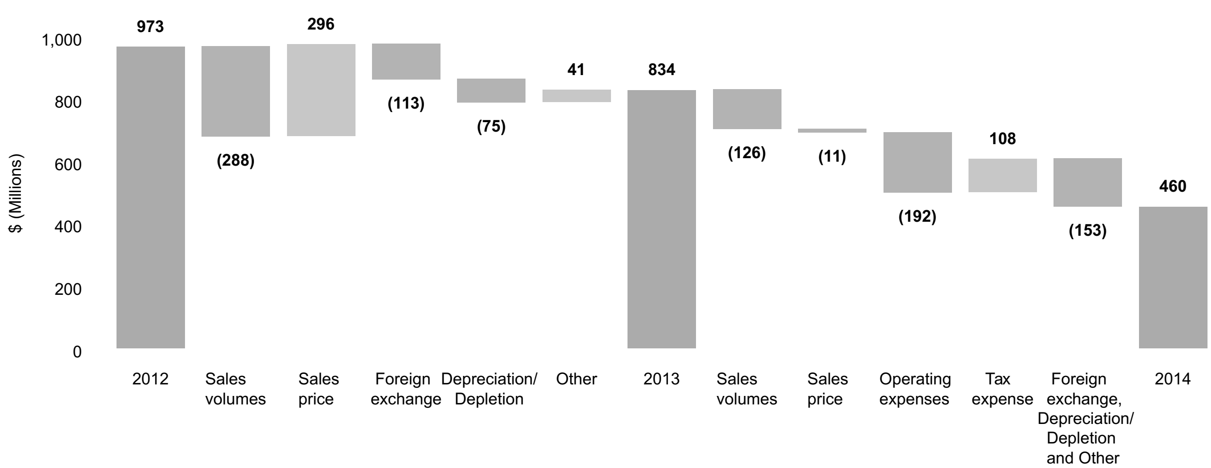
### Cash Flow from Operations




Cash flow from operations decreased in 2014 from 2013, as higher operating expenses and lower sales volumes were partially offset by lower current taxes. The decrease in cash flow from operations in 2013 from 2012 mainly reflects lower sales volumes and higher current taxes, partially offset by a higher realized selling price.

The changes in the components of cash flow from operations are discussed in greater detail later in this MD&A.

## Net Income




Canadian Oil Sands reported net income of $460 million or $0.95 per Share, in 2014 compared with $834 million, or $1.72 per Share, in 2013, primarily reflecting the same factors that impacted cash flow from operations. Additionally, foreign exchange losses and depreciation and depletion expense were higher in 2014 compared with 2013.

Net income decreased to $834 million, or $1.72 per Share, in 2013 from $973 million, or $2.01 per Share, in 2012. Lower sales volumes were largely offset by a higher realized selling price in 2013. However, the Corporation recorded a foreign exchange loss in 2013 as opposed to a foreign exchange gain in 2012 and recorded a higher depreciation and depletion expense in 2013.

The changes in the components of net income are discussed in greater detail later in this MD&A.

The following table shows net income components per barrel of SCO.

| *($ per barrel)*[1] | **2014** | 2013 | 2012 |
|---|---|---|---|
| Sales net of crude oil purchases and transportation expense | **$ 99.06** | $ 99.63 | $ 92.20 |
| Operating expense | **(48.86)** | (41.75) | (38.91) |
| Crown royalties | **(6.39)** | (4.85) | (5.21) |
| | **$ 43.81** | $ 53.03 | $ 48.08 |
| Development expense | **$ (4.34)** | $ (3.72) | $ (2.62) |
| Administration and insurance expenses | **(1.05)** | (1.16) | (0.94) |
| Depreciation and depletion expense | **(14.89)** | (13.36) | (10.41) |
| Net finance expense | **(1.36)** | (1.21) | (1.45) |
| Foreign exchange gain (loss) | **(3.87)** | (2.46) | 0.65 |
| Tax expense | **(4.94)** | (7.79) | (8.15) |
| | **(30.45)** | (29.70) | (22.92) |
| Net income per barrel | **$ 13.36** | $ 23.33 | $ 25.16 |
| Sales volumes (mmbbls)[2] | **34.5** | 35.8 | 38.7 |

*[1] Per barrel measures derived by dividing the relevant item by sales volumes in the period.*
*[2] Sales volumes, net of purchased crude oil volumes.*

Net income components on a per barrel basis reflect the items previously noted as well as decreasing sales volumes over the three years presented.

## Sales Net of Crude Oil Purchases and Transportation Expense

| *($ millions, except where otherwise noted)* | **2014** | 2013 | 2012 | Changes 2014 vs 2013 | 2013 vs 2012 |
|---|---|---|---|---|---|
| Sales[1] | **$ 3,912** | $ 4,208 | $ 3,905 | $ (296) | $ 303 |
| Crude oil purchases | **(443)** | (591) | (295) | 148 | (296) |
| Transportation expense | **(50)** | (52) | (44) | 2 | (8) |
| | **$ 3,419** | $ 3,565 | $ 3,566 | $ (146) | $ (1) |
| Sales volumes[2] | | | | | |
| Total (mmbbls) | **34.5** | 35.8 | 38.7 | (1.3) | (2.9) |
| Daily average (bbls) | **94,557** | 98,037 | 105,680 | (3,480) | (7,643) |
| Realized SCO selling price[3] (average $Cdn/bbl) | **$ 99.24** | $ 99.55 | $ 91.90 | $ (0.31) | $ 7.65 |
| West Texas Intermediate ("WTI") (average $US/bbl) | **$ 92.91** | $ 98.05 | $ 94.15 | $ (5.14) | $ 3.90 |
| SCO premium (discount) to WTI (weighted-average $Cdn/bbl) | **$ (2.55)** | $ (1.10) | $ (2.42) | $ (1.45) | $ 1.32 |
| Average foreign exchange rate ($US/$Cdn) | **$ 0.91** | $ 0.97 | $ 1.00 | $ (0.06) | $ (0.03) |

[1] *Sales include sales of purchased crude oil and sulphur.*
[2] *Sales volumes, net of purchased crude oil volumes.*
[3] *SCO sales net of crude oil purchases and transportation expense divided by sales volumes, net of purchased crude oil volumes.*

Sales, net of crude oil purchases and transportation expense decreased by $146 million in 2014, as a result of lower sales volumes relative to 2013.

- Sales volumes in 2014 averaged 94,600 barrels per day, down from sales volumes of 98,000 barrels per day in 2013 due to an unplanned Coker 8-1 outage and unplanned outages in sulphur processing units and a sour water treatment unit.
- The 2014 realized selling price was largely unchanged from 2013, reflecting a weaker U.S. dollar WTI price and a deterioration of the SCO differential to WTI, offset by a weaker average Canadian dollar.

Sales, net of crude oil purchases and transportation expense in 2013 were largely unchanged from 2012 with a higher realized selling price offset by lower sales volumes.

- The 2013 realized selling price increased by $8 per barrel relative to 2012, reflecting a stronger U.S. dollar WTI price, a weaker average Canadian dollar, and an improvement in the SCO differential to WTI.
- Sales volumes in 2013 were lower than in 2012, reflecting delays completing the Coker 8-1, LC Finer and secondary upgrading unit turnarounds.

The Corporation purchases crude oil from third parties to fulfill sales commitments with customers when there are shortfalls in Syncrude's production and to facilitate certain transportation arrangements. Higher crude oil purchases in 2013 reflect higher purchased volumes to support production shortfalls and transportation arrangements, as well as higher crude oil prices.

## Operating Expenses

The following table shows the major components of operating expenses in total dollars and per barrel of SCO:

| | 2014 | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| | $ millions | $ per bbl | $ millions | $ per bbl | $ millions | $ per bbl |
| Production and maintenance[1] | **$ 1,335** | **$ 38.68** | $ 1,217 | $ 34.01 | $ 1,242 | $ 32.12 |
| Natural gas and diesel purchases[2] | **207** | **6.01** | 144 | 4.02 | 125 | 3.22 |
| Syncrude pension and incentive compensation | **101** | **2.92** | 98 | 2.74 | 97 | 2.52 |
| Other[3] | **43** | **1.25** | 35 | 0.98 | 41 | 1.05 |
| Total operating expenses | **$ 1,686** | **$ 48.86** | $ 1,494 | $ 41.75 | $ 1,505 | $ 38.91 |

*[1] Includes non-major turnaround costs. Major turnaround costs are capitalized as property, plant and equipment.*
*[2] Includes costs to purchase natural gas used to produce energy and hydrogen and diesel consumed as fuel. Natural gas prices averaged $4.36 per GJ in 2014, $3.09 per GJ in 2013 and $2.34 per GJ in 2012. Diesel prices averaged $0.99 per litre in 2014, $0.91 per litre in 2013 and $0.90 per litre in 2012.*
*[3] Includes fees for management services provided by Imperial Oil Resources, insurance premiums, and greenhouse gas emissions levies.*

Operating expenses increased by $192 million in 2014 compared with 2013 due to additional maintenance costs associated with unplanned outages on upgrading units, higher drilling and tailings management activities and higher natural gas prices.

In 2013, operating expenses decreased by $11 million relative to 2012, reflecting lower production costs, primarily due to lower mining volumes. The decrease in production costs was partially offset by higher maintenance costs associated with extended turnarounds and unplanned outages in extraction.

The increase in per barrel operating expenses also reflects a relatively high proportion of fixed operating costs over lower sales volumes over the past three years.

The following table shows operating expenses per barrel of bitumen and SCO. Costs are allocated to bitumen production and upgrading on the basis used to determine Crown royalties.

| | 2014 | | 2013[3] | | 2012 | |
|---|---|---|---|---|---|---|
| *($ per barrel)* | Bitumen | SCO | Bitumen | SCO | Bitumen | SCO |
| Bitumen production | **$ 29.08** | **$ 34.56** | $ 26.91 | $ 32.52 | $ 25.54 | $ 29.54 |
| Internal fuel allocation[1] | **2.92** | **3.47** | 2.52 | 3.05 | 2.15 | 2.48 |
| Total bitumen production expenses | **$ 32.00** | **$ 38.03** | $ 29.43 | $ 35.57 | $ 27.69 | $ 32.02 |
| Upgrading[2] | | **$ 14.30** | | $ 9.23 | | $ 9.37 |
| Less: internal fuel allocation[1] | | **(3.47)** | | (3.05) | | (2.48) |
| Total upgrading expenses | | **$ 10.83** | | $ 6.18 | | $ 6.89 |
| Total operating expenses | | **$ 48.86** | | $ 41.75 | | $ 38.91 |
| *(thousands of barrels per day)* | | | | | | |
| Syncrude production volumes | **307** | **258** | 323 | 267 | 331 | 287 |
| Canadian Oil Sands sales volumes | | **95** | | 98 | | 106 |

*[1] Reflects energy generated by the upgrader that is used in the bitumen production process and is valued by reference to natural gas and diesel prices.*
*[2] Upgrading expenses include the production and maintenance expenses associated with processing and upgrading bitumen to SCO.*
*[3] Certain comparative amounts have been reclassified to conform to the current year presentation.*

## Crown Royalties

Crown royalties were $221 million in 2014, $174 million in 2013, and $202 million in 2012. The increase in 2014 relative to 2013 mainly reflects lower deductible capital expenditures. The decrease in 2013 Crown royalties from 2012 was due to higher deductible capital expenditures, reflecting costs to replace or relocate Syncrude mine trains and to support tailings management plans, and lower bitumen production volumes.

From 2009 through 2015, Syncrude's Crown royalties are determined pursuant to the Syncrude Royalty Amending Agreement ("Syncrude RAA") and the Syncrude Bitumen Royalty Option Agreement.

The Syncrude RAA requires that bitumen be valued by a formula that references the value of bitumen based on a Canadian heavy oil reference price adjusted to reflect quality and location differences between Syncrude's bitumen and the Canadian reference price bitumen. In addition, the agreement provides that a minimum bitumen value, or "floor price", may be imposed in circumstances where Canadian heavy oil prices are temporarily suppressed relative to North American heavy oil prices.

Under the Syncrude RAA, the Syncrude owners pay the greater of 25 per cent of net revenues, or one per cent of gross revenues, plus a transition royalty of up to $975 million ($358 million net to the Corporation) for the period January 1, 2010 to December 31, 2015. The transition royalty is proportionally reduced if bitumen production is less than 345,000 barrels per day over the period and is scheduled over six annual installments as follows:

| *($ millions)* | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Total |
|---|---|---|---|---|---|---|---|
| Syncrude | $ 75 | $ 75 | $ 100 | $ 150 | $ 225 | $ 350 | $ 975 |
| Canadian Oil Sands' share | $ 27 | $ 27 | $ 37 | $ 55 | $ 83 | $ 129 | $ 358 |

Under the Syncrude Bitumen Royalty Option Agreement, costs related to capital expenditures that were deducted in computing Crown royalties on SCO prior to 2009, and are no longer associated with the royalty base, are recaptured by the Crown. These recapture amounts vary based on Government of Canada long-term bond rates and result in approximately $25 million of additional Crown royalties per year, net to the Corporation, over a 25-year period ending in 2033.

Subsequent to 2015, Syncrude's Crown royalties will be determined pursuant to the generic Crown royalty framework that applies to most of the oil sands industry in Alberta. Details regarding the framework can be found in our AIF dated February 24, 2015.

**Development Expenses**

Development expenses totaled $150 million in 2014, $133 million in 2013 and $101 million in 2012. Development expenses consist primarily of expenditures relating to capital programs, which are expensed, such as pre-feasibility engineering, technical and support services, research, evaluation drilling and regulatory and stakeholder consultation expenditures. Development expenses can vary from period to period depending on the number of projects underway and the development stage of the projects. The increase in development expenses over the past three years was related to Syncrude's major projects, which are nearing completion.

**Depreciation and Depletion Expense**

Depreciation and depletion expense increased to $514 million in 2014 from $478 million in 2013 and $403 million in 2012. The increase over the three-year period is attributable to new depreciation charges on the Syncrude Emissions Reduction (SER) project that was completed in 2012 and significant tailings and lease development projects that were completed in 2013. A portion of the increase in 2013 relative to 2012 reflects a $35 million write-off of Arctic natural gas assets.

**Net Finance Expense**

| *($ millions)* | **2014** | 2013 | 2012[1] |
|---|---|---|---|
| Interest costs on long-term debt | **$ 119** | $ 123 | $ 117 |
| Less capitalized interest on long-term debt | **(111)** | (107) | (92) |
| Interest expense on long-term debt | **$ 8** | $ 16 | $ 25 |
| Interest expense on employee future benefits | **14** | 16 | 17 |
| Accretion of asset retirement obligation | **28** | 26 | 26 |
| Interest income | **(3)** | (14) | (12) |
| Net finance expense | **$ 47** | $ 44 | $ 56 |

[1] *Net finance expense in 2012 has been adjusted to reflect the amendments to IAS 19, Employee Benefits.*

Interest costs on the Corporation's U.S. dollar-denominated long-term debt reflect lower average outstanding debt levels in 2014 due to a U.S. $300 million debt repayment in August, 2013, partially offset by a weaker Canadian dollar. Interest expense on long-term debt decreased over the three-year period because a growing portion of interest costs were capitalized, concurrent with higher spending on major capital projects. Interest income was lower in 2014 relative to 2013 and 2012 due to lower cash balances.

## Foreign Exchange

| ($ millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Foreign exchange (gain) loss – long-term debt | **$ 145** | $ 115 | $ (28) |
| Foreign exchange (gain) loss – other | **(11)** | (27) | 3 |
| Total foreign exchange (gain) loss | **$ 134** | $ 88 | $ (25) |

Foreign exchange gains and losses are the result of revaluations of the Corporation's U.S. dollar-denominated long-term debt, accounts receivable and cash into Canadian dollars.

The Canadian dollar weakened in 2013 and 2014 with a $US/$Cdn exchange rate of $1.01 at December 31, 2012, $0.94 at December 31, 2013 and $0.86 at December 31, 2014.

In 2012, the Canadian dollar strengthened from a $US/$Cdn exchange rate of $0.98 at December 31, 2011 to $1.01 at December 31, 2012.

## Tax Expense

| ($ millions) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Current tax expense | **$ 172** | $ 297 | $ 40 |
| Deferred tax expense (recovery) | **(1)** | (18) | 275 |
| Total tax expense | **$ 171** | $ 279 | $ 315 |

Lower total tax expense over the past three years reflects lower net income before taxes.

Lower current tax in 2012 was a result of tax pools that were available to shelter a majority of the income earned that year. Also, taxes on a portion of income generated in the Corporation's partnership in 2012 were deferred to 2013.

Current tax in 2014 was lower than in 2013 mainly due to lower taxable income generated from the Corporation's partnership.

## Asset Retirement Obligation

| ($ millions) | 2014 | 2013 |
|---|---|---|
| Asset retirement obligation, beginning of year | **$ 896** | $ 1,102 |
| (Increase) decrease in risk-free interest rate | **224** | (217) |
| Reclamation expenditures | **(18)** | (42) |
| Increase in estimated reclamation and closure expenditures | **89** | 27 |
| Accretion expense | **28** | 26 |
| Asset retirement obligation, end of year | **$ 1,219** | $ 896 |
| Less current portion | **(18)** | (28) |
| Non-current portion | **$ 1,201** | $ 868 |

Canadian Oil Sands' asset retirement obligation increased from $896 million at December 31, 2013 to $1.2 billion at December 31, 2014 primarily due to a decrease in the interest rate used to discount future reclamation and closure expenditures. The change in discount rate from 3.25 per cent at December 31, 2013 to 2.25 per cent at December 31, 2014 resulted in a $224 million increase in the asset retirement obligation.

In addition, the annual review of estimated future reclamation and closure expenditures resulted in an $89 million increase in the discounted asset retirement obligation, or a $215 million increase in the undiscounted obligation, reflecting the planned extension of the Mildred Lake mine and higher costs for material movement.

In 2013, the Corporation's asset retirement obligation decreased primarily due to an increase in the interest rate used to discount future reclamation and closure expenditures from 2.25 per cent at December 31, 2012 to 3.25 per cent at December 31, 2013.

### Pension and Other Post-Employment Benefit Plans

| ($ millions) | 2014 | 2013 |
|---|---|---|
| Accrued benefit liability, beginning of year | **$ 308** | $ 438 |
| Current service cost | **42** | 45 |
| Interest expense | **14** | 16 |
| Contributions | **(48)** | (109) |
| Re-measurement (gains) losses: | | |
| Return on plan assets (excluding amounts included in net finance expense)[1] | **(76)** | (46) |
| (Increase) decrease in discount rate | **100** | (91) |
| Other[2] | **(2)** | 55 |
| Accrued benefit liability, end of year | **$ 338** | $ 308 |
| Less current portion | **(20)** | (82) |
| Non-current portion | **$ 318** | $ 226 |

*[1] Interest earned on plan assets included in net finance expense was $34 million (2013 - $26 million).*
*[2] The other re-measurement loss in 2013 reflects an increase in the estimated average lifespan of the plans' beneficiaries as a result of new actuarial standards.*

The Corporation's obligation for Syncrude Canada Ltd.'s ("Syncrude Canada") accrued benefit liability increased to $338 million at December 31, 2014 from $308 million at December 31, 2013 due to a 50 basis point decrease in the interest rate used to discount the accrued benefit liability, partially offset by higher than expected actual returns on plan assets.

The $130 million decrease in the accrued benefit liability in 2013 reflects a 50 basis point increase in the interest rate used to discount the accrued benefit liability, higher-than-estimated returns on plan assets and contributions to the plans in excess of the current period expenses. These factors were partially offset by the impact of an increase in the estimated average lifespan of the plans' beneficiaries as a result of new actuarial standards.

Contributions to Syncrude Canada's registered pension plans decreased in 2014 due to a reduction in payments prescribed by regulations resulting from the actuarial valuation completed in April, 2014. Prior to the valuation, higher annual prescribed contributions were required to fund large deficits in the registered pension plans. When the actuarial valuation was completed in 2014, the deficits were reduced due to the significant contributions in 2012 and 2013, as well as changes in actuarial assumptions.

## Summary of Quarterly Results

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Sales[1] ($ millions) | **$ 809** | $ 829 | $ 786 | $ 995 | $ 945 | $ 871 | $ 921 | $ 828 |
| Net income ($ millions) | **$ 25** | $ 87 | $ 176 | $ 172 | $ 192 | $ 246 | $ 219 | $ 177 |
| Per Share, Basic & Diluted | **$ 0.05** | $ 0.18 | $ 0.36 | $ 0.35 | $ 0.40 | $ 0.51 | $ 0.45 | $ 0.37 |
| Cash flow from operations[2] ($ millions) | **$ 207** | $ 302 | $ 240 | $ 357 | $ 392 | $ 339 | $ 340 | $ 275 |
| Per Share[2] | **$ 0.43** | $ 0.62 | $ 0.50 | $ 0.74 | $ 0.81 | $ 0.70 | $ 0.70 | $ 0.57 |
| Dividends ($ millions) | **$ 169** | $ 170 | $ 169 | $ 170 | $ 169 | $ 170 | $ 169 | $ 170 |
| Per Share | **$ 0.35** | $ 0.35 | $ 0.35 | $ 0.35 | $ 0.35 | $ 0.35 | $ 0.35 | $ 0.35 |
| Daily average sales volumes[3] (bbls) | **108,139** | 87,787 | 77,064 | 105,283 | 112,092 | 84,250 | 100,094 | 95,683 |
| Realized SCO selling price ($/bbl) | **$ 81.32** | $ 102.58 | $ 112.04 | $ 105.73 | $ 91.47 | $ 112.55 | $ 100.90 | $ 96.11 |
| WTI[4] (average $US/bbl) | **$ 73.20** | $ 97.25 | $ 102.99 | $ 98.61 | $ 97.61 | $ 105.81 | $ 94.17 | $ 94.36 |
| SCO premium (discount) to WTI (weighted-average $/bbl) | **$ (3.23)** | $ (3.14) | $ (0.37) | $ (2.93) | $ (10.84) | $ 2.63 | $ 4.79 | $ 1.00 |
| Operating expenses[5] ($/bbl) | **$ 44.04** | $ 47.73 | $ 59.64 | $ 46.91 | $ 37.60 | $ 46.15 | $ 43.23 | $ 41.20 |
| Capital expenditures ($ millions) | **$ 170** | $ 222 | $ 321 | $ 217 | $ 292 | $ 413 | $ 369 | $ 268 |
| Purchased natural gas price ($/GJ) | **$ 3.63** | $ 3.94 | $ 4.45 | $ 5.43 | $ 3.28 | $ 2.59 | $ 3.41 | $ 2.95 |
| Foreign exchange rates ($US/$Cdn) | | | | | | | | |
| Average | **$ 0.88** | $ 0.92 | $ 0.92 | $ 0.91 | $ 0.95 | $ 0.96 | $ 0.98 | $ 0.99 |
| Quarter-end | **$ 0.86** | $ 0.89 | $ 0.94 | $ 0.90 | $ 0.94 | $ 0.97 | $ 0.95 | $ 0.98 |

*[1] Sales after crude oil purchases and transportation expense.*

*[2] Cash flow from operations and cash flow from operations per Share are additional GAAP financial measures and are defined in the "Additional GAAP Financial Measures" section of this MD&A.*

*[3] Daily average sales volumes net of crude oil purchases.*

*[4] Pricing obtained from Bloomberg.*

*[5] Derived from operating expenses, as reported on the Consolidated Statements of Income and Comprehensive Income, divided by sales volumes during the period.*

During the last eight quarters, the following items have had a significant impact on the Corporation's financial results and may impact the financial results in the future:

- Fluctuations in realized selling prices have affected the Corporation's sales. During the last eight quarters, quarterly average WTI prices have ranged from U.S. $73 per barrel to U.S. $106 per barrel, and the quarterly average SCO differentials to WTI have ranged from an $11 per barrel discount to a $5 per barrel premium.
- U.S. to Canadian dollar exchange rate fluctuations have resulted in foreign exchange gains and losses on the revaluation of U.S. dollar-denominated debt and have impacted realized selling prices.
- Planned maintenance activities and unplanned outages have impacted quarterly sales volumes, revenues, operating expenses and per barrel results.
- Environmental and tailings management activities to meet regulatory requirements have contributed to increasing operating expenses.
- Changes in bitumen values have impacted Crown royalties.
- Major capital projects to replace or relocate Syncrude mine trains and to support tailings management plans have increased capital expenditures, reduced Crown royalties and lowered net finance expense over the past eight quarters. These projects are substantially complete at the end of 2014, increasing future depreciation and depletion expense.
- Fluctuations in natural gas prices have impacted operating expenses.

The supply/demand balance for crude oil affects selling prices, however, the impact of this relationship has not displayed significant seasonality. Syncrude production levels may likewise not display seasonal patterns or trends. While maintenance and turnaround activities are typically scheduled in the spring and fall, the timing of unit outages cannot always be precisely scheduled and unplanned outages may occur. The costs of major turnarounds are capitalized as property, plant and equipment and depreciated over the period until the next scheduled turnaround. The costs of all other turnarounds and maintenance activities are expensed in the period incurred, which can result in volatility in quarterly operating expenses. Given the relatively fixed nature of operating costs, all turnaround and maintenance activities impact per-barrel operating expenses because sales volumes are lower in the periods when this work is occurring.

## Capital Expenditures

| *($ millions)* | **2014** | 2013 | 2012 |
|---|---|---|---|
| **Major Projects** | | | |
| Mildred Lake Mine Train Replacement | **$ 289** | $ 457 | $ 362 |
| Centrifuge Tailings Management | **273** | 229 | 69 |
| Aurora North Mine Train Relocations | **—** | 149 | 98 |
| Aurora North Tailings Management | **—** | 77 | 123 |
| **Capital expenditures on major projects** | **$ 562** | $ 912 | $ 652 |
| **Regular maintenance** | | | |
| Capitalized turnaround costs | **$ 71** | $ 54 | $ 76 |
| Other | **186** | 269 | 266 |
| **Capital expenditures on regular maintenance** | **$ 257** | $ 323 | $ 342 |
| **Capitalized interest** | **$ 111** | $ 107 | $ 92 |
| **Total capital expenditures** | **$ 930** | $ 1,342 | $ 1,086 |

Capital expenditures decreased to $930 million in 2014 from $1,342 million in 2013 and $1,086 million in 2012, reflecting the completion of several tailings and lease development projects in 2013, including two major projects: Aurora North Mine Train Relocations and Aurora North Tailings Management. In addition, the Mildred Lake Mine Train Replacement project was completed in 2014.

More information on the major projects is provided in the “Outlook” section of this MD&A.

## Contractual Obligations and Commitments

The following table outlines the significant contractual obligations and commitments that were assumed as part of the normal course of operations as at December 31, 2014. These obligations and commitments represent future cash payments that the Corporation is required to make under existing contractual agreements that it has entered into either directly, or as a 36.74 per cent owner in Syncrude. The principal payments and accrued interest due on long-term debt, the asset retirement obligation and the pension plan solvency deficiency payments are recognized as liabilities in the Corporation's consolidated financial statements. The other contractual obligations and commitments are not recognized as liabilities.

| | | Cash Outflow By Period | | | |
|---|---|---|---|---|---|
| *($ millions)* | **Total** | **2015** | **2016 to 2017** | **2018 to 2019** | **After 2019** |
| Long-term debt[1] | $ 2,924 | $ 117 | $ 233 | $ 785 | $ 1,789 |
| Asset retirement obligation[2] | 2,375 | 18 | 35 | 73 | 2,249 |
| Pipeline and storage[3] | 2,294 | 67 | 129 | 173 | 1,925 |
| Other[4] | 390 | 178 | 117 | 31 | 64 |
| | $ 7,983 | $ 380 | $ 514 | $ 1,062 | $ 6,027 |

*1 Reflects principal and interest payments on Senior Notes and excludes $140 million drawn on our credit facilities.*

*2 Reflects Canadian Oil Sands' 36.74 per cent share of the undiscounted estimated future expenditures required to settle Syncrude's obligation to reclaim and close each of its mine sites and decommission its utilities plants, bitumen extraction plants, and upgrading complex.*

*3 Reflects Canadian Oil Sands' take-or-pay commitments for the transportation and storage of crude oil, primarily on proposed pipelines that are still subject to regulatory approval.*

*4 Primarily reflects Canadian Oil Sands' 36.74 per cent share of Syncrude's commitments for natural gas and diesel purchases at floating market prices, payments required to fund Syncrude Canada's registered pension plan solvency deficiency, and Syncrude's commitment to purchase tires.*

## Dividends

Dividend payments are set quarterly by the Board of Directors in the context of current and expected crude oil prices, economic conditions, Syncrude's operating performance and the Corporation's capacity to finance operating and investing obligations. Dividend amounts are established with the intent of absorbing short-term market volatility over several quarters, while maintaining a strong balance sheet to reduce exposure to potential oil price declines, cost increases or major operational upsets. The Corporation paid dividends to shareholders totaling $678 million, or $1.40 per Share, in 2014.

COS has reduced its quarterly dividend to $0.05 per Share for the first quarter of 2015 to align with the current crude oil price environment and as a prudent step to preserve balance sheet strength in the short and medium term.

The quarterly dividend was declared by the Corporation on January 29, 2015, for a total dividend of approximately $24 million. The dividend will be paid on February 27, 2015 to shareholders of record on February 20, 2015.

## Liquidity and Capital Resources

| As at *($ millions, except % amounts)* | **December 31 2014** | December 31 2013 | December 31 2012 |
|---|---|---|---|
| Long-term debt[1, 2] | **$ 1,889** | $ 1,602 | $ 1,794 |
| Cash and cash equivalents[1] | **(33)** | (806) | (1,553) |
| Net debt[3,4] | **$ 1,856** | $ 796 | $ 241 |
| Shareholders' equity[1] | **$ 4,497** | $ 4,732 | $ 4,515 |
| Total net capitalization[3,5] | **$ 6,353** | $ 5,528 | $ 4,756 |
| Total capitalization[3,6] | **$ 6,386** | $ 6,334 | $ 6,309 |
| Net debt-to-total net capitalization[3,7] (%) | **29** | 14 | 5 |
| Long-term debt-to-total capitalization[3,8] (%) | **30** | 25 | 28 |

[1] *As reported in the Consolidated Balance Sheets.*
[2] *Includes current and non-current portions of long-term debt.*
[3] *Additional GAAP financial measure.*
[4] *Long-term debt less cash and cash equivalents.*
[5] *Net debt plus Shareholders' equity.*
[6] *Long-term debt plus Shareholders' equity.*
[7] *Net debt divided by total net capitalization.*
[8] *Long-term debt divided by total capitalization.*

Net debt rose in 2014 to $1,856 million from $796 million in 2013 and $241 million in 2012, concurrent with higher spending on major capital projects over the three-year period. In addition, a weakening Canadian dollar over the same period increased the Canadian dollar equivalent value of long-term debt. As a result, net debt-to-total net capitalization increased to 29 per cent at December 31, 2014 from 14 per cent at December 31, 2013 and five per cent at December 31, 2012.

To supplement cash flow from operations and in preparation for a Senior Note maturity, Canadian Oil Sands issued U.S. $700 million of unsecured Senior Notes in March 2012. In August 2013, Canadian Oil Sands repaid U.S. $300 million of Senior Notes upon maturity.

In July 2014, Canadian Oil Sands extended the terms of its credit facilities. The $1.5 billion credit facility was extended to June 30, 2018 and the $40 million credit facility to June 30, 2016. As at December 31, 2014, $140 million was drawn against these facilities (December 31, 2013 and December 31, 2012 - $nil).

Shareholders' equity decreased to $4,497 million at December 31, 2014 from $4,732 million at December 31, 2013, as dividends exceeded comprehensive income during the year.

At December 31, 2014, Canadian Oil Sands had a working capital deficiency of $75 million. Based on the assumptions in our 2015 Outlook, Canadian Oil Sands will have sufficient cash flow from operations to fund the working capital deficiency.

Canadian Oil Sands' Senior Notes indentures and credit facility agreements contain certain covenants that restrict Canadian Oil Sands' ability to sell all or substantially all of its assets or change the nature of its business, and limit long-term debt-to-total capitalization to 55 per cent. With a long-term debt-to-total capitalization of 30 per cent at December 31, 2014, a significant increase in debt or decrease in equity would be required to negatively impact the Corporation's financial flexibility.

## Shareholders' Capital and Trading Activity

Canadian Oil Sands issues options, performance share units ("PSUs"), and restricted share units ("RSUs") under its long-term incentive plans for employees, and deferred share units ("DSUs") as a component of non-executive directors' compensation.

Options are share-based compensation awards which provide the holder with the right to purchase a Share at an exercise price determined at the date of grant. For options granted prior to 2011, exercise prices are reduced by dividends over a threshold amount. Subject to certain exemptions relating to retirement, death or termination, the options vest by one-third following the date of grant in each of the first three years and expire seven years after the date of grant. At December 31, 2014, there were 3,852,403 options outstanding with a weighted-average exercise price of $23.44 per option. Thus far in 2015, 240,440 options have expired and 1,757,940 options were granted.

PSUs are share-based compensation awards with a settlement value based on the Corporation's Share price at the end of a three-year vesting period, dividends paid by the Corporation during the vesting period and the total Shareholder return generated by the Corporation relative to a comparator group, comprised of other industry peers, over the vesting period. PSUs are settled in cash, in Shares purchased in the secondary market, or in Shares issued from treasury. At December 31, 2014, there were 314,094 PSUs outstanding with an accrued value of approximately $0.5 million. Thus far in 2015, 89,476 PSUs have matured and 222,781 PSUs were granted.

RSUs are share-based compensation awards with a settlement value based on the Corporation's Share price at the end of a three-year vesting period and dividends paid by the Corporation during that period. RSUs are settled in cash, in Shares purchased in the secondary market or in Shares issued from treasury. At December 31, 2014, there were 36,996 RSUs outstanding with an accrued value of approximately $0.2 million. Thus far in 2015, 7,929 RSUs have matured and 41,242 RSUs were granted.

DSUs are share-based compensation awards with a settlement value based on the Corporation's Share price on the settlement date and dividends paid by the Corporation while the DSUs are outstanding. DSUs vest immediately upon grant and settle when a director's service ceases. DSUs are awarded and settled in cash, in Shares purchased in the secondary market or in Shares issued from treasury. At December 31, 2014 and February 24, 2015, there were 137,138 DSUs outstanding with an accrued value of approximately $1.4 million.

The share-based compensation awards outstanding at February 24, 2015 represent less than one per cent of total Shares outstanding on a Share-equivalent basis. More detail on the Corporation's options, PSUs, RSUs and DSUs can be found in the Corporation's Management Proxy Circular dated March 17, 2014, which is available on our website at **www.cdnoilsands.com** or at **www.sedar.com**.

The Corporation's shares trade on the Toronto Stock Exchange under the symbol COS. On December 31, 2014, the Corporation had a market capitalization of approximately $5 billion with 484.6 million shares outstanding and a closing price of $10.42 per Share. A table summarizing the Shares issued in 2014 is included in Note 13 to the consolidated financial statements.The following table summarizes the trading activity for 2014.

| | Total 2014 | Fourth Quarter 2014 | Third Quarter 2014 | Second Quarter 2014 | First Quarter 2014 |
|---|---|---|---|---|---|
| Share price | | | | | |
| High | 24.68 | $ 20.74 | $ 24.37 | $ 24.68 | $ 23.39 |
| Low | 8.20 | $ 8.20 | $ 20.15 | $ 22.31 | $ 19.64 |
| Close | 10.42 | $ 10.42 | $ 20.66 | $ 24.18 | $ 23.19 |
| Volume of Shares traded (millions) | 476.3 | 220.8 | 81.7 | 86.1 | 87.7 |
| Weighted average Shares outstanding (millions) | 484.6 | 484.6 | 484.6 | 484.6 | 484.6 |

**Premium Dividend, Dividend Reinvestment and Optional Share Purchase Plan**
The Corporation has a Premium Dividend, Dividend Reinvestment and Optional Share Purchase Plan (“DRIP”) which allows eligible Shareholders to direct their dividends to the purchase of additional Shares or receive a premium dividend amount. The DRIP is suspended but could be reinstated in the future to help preserve balance sheet equity or fund future capital investment.

## Critical Accounting Estimates and Judgments

In order to provide timely financial information to users, the Corporation makes estimates and uses judgment when determining the assets, liabilities, revenues, expenses, commitments and contingencies reported in the consolidated financial statements and notes. The following estimates and judgments are considered critical because actual results could differ materially from reported results if different assumptions underlying these estimates and judgments were used:

***Critical Accounting Estimates***

**a) Asset Retirement Obligation**
In determining the estimated value of the asset retirement obligation, Canadian Oil Sands must estimate the method of reclamation and closure activities, the mine development plans and the timing and amount of associated expenditures. Given the long reserve life of Syncrude’s leases and emerging technologies in site reclamation, it is difficult to estimate the precise timing and amount of these expenditures. Any changes in the anticipated method or in the timing or amount of expenditures could result in a change to the asset retirement obligation, corresponding property, plant and equipment (“PP&E”) asset, accretion expense (within net finance expense), and depreciation and depletion expense.

**b) Employee Future Benefits**
Canadian Oil Sands accrues its obligations for Syncrude Canada’s post-employment benefits using actuarial and other assumptions to estimate the accrued benefit liability and the expense related to the current period. Changes in these assumptions or plan asset returns not included in the accretion of the accrued benefit liability give rise to re-measurement gains and losses. A one per cent decrease in the interest rate used to discount future benefit payments would result in a $232 million increase in Canadian Oil Sands’ accrued benefit liability, a $14 million increase in 2014 current service costs and a $3 million decrease in the 2014 interest expense, while a one per cent increase in the interest rate would result in a $178 million decrease in the accrued benefit liability, a $10 million decrease in 2014 current service costs and a $2 million increase in the 2014 interest expense.

**c) Impairment**
In determining the recoverable amount of assets subject to impairment testing, Canadian Oil Sands must estimate the reserves and resources it expects to recover and the related future net revenues expected to be generated from producing those reserves and resources. Reserves, resources and future net revenues are evaluated by independent petroleum reserve evaluators who determine these evaluations using various factors and assumptions, such as: forecasts of mining and extraction recovery and upgrading yield based on geological and engineering data, projected future rates of production, projected operating costs, Crown royalties and taxes, projected crude oil prices, oil price differentials, and timing and amounts of future capital expenditures and other development costs, all of which are estimates. The factors and assumptions used in the estimates are assessed for reasonableness based on the information available at the time the estimates are prepared. As circumstances change and new information becomes available, the estimates could change. Actual results could vary from estimates, which could cause changes to the asset impairment tests.

**d) Depreciation and Depletion**
Canadian Oil Sands calculates depreciation expense for the majority of its assets on a straight-line basis and must estimate the useful lives of these assets accordingly. While these useful life estimates are reviewed on a regular basis and depreciation calculations are revised accordingly, actual lives may differ from the estimates, resulting in changes to depreciation expense. Canadian Oil Sands calculates depletion expense for asset retirement and mine development costs on a unit-of-production basis and must estimate reserves and resources, which are used as a component of the depletion calculations to allocate capital costs over their estimated useful lives. As circumstances change and new information becomes available, estimated reserves and resources and the resultant depletion calculations could change.

***Critical Accounting Judgments***

**a) Joint Arrangements**

Canadian Oil Sands has applied judgment in determining that Syncrude is under joint control. This determination recognizes that all major growth decisions outside of the original scope of the operations and all product quality changes require unanimous approval of Syncrude's joint interest owners. Because Canadian Oil Sands' investment in Syncrude is primarily held through an undivided interest, it has a proportionate share of the rights to Syncrude's assets and the obligations for Syncrude's liabilities. As a result, Canadian Oil Sands classifies its investment in Syncrude as a *Joint Operation* under International Financial Reporting Standard ("IFRS") 11, *Joint Arrangements*, and presents its proportionate share of the assets, liabilities, revenues and expenses on a line-by-line basis in the consolidated financial statements. If Canadian Oil Sands did not have both joint control and a proportionate share of the rights to Syncrude's assets and obligations for Syncrude's liabilities, the Corporation would present only its net investment in Syncrude and its proportionate share of Syncrude's net income in the consolidated financial statements.

**b) Asset Retirement Obligation**

Canadian Oil Sands applies judgment in determining that the risk-free interest rate is the appropriate rate to discount the asset retirement obligation. Alternatively, a credit-adjusted rate could be used which would yield a smaller asset retirement obligation and corresponding PP&E asset, lower depreciation and depletion expense and a higher accretion expense, which is presented within net finance expense.

**c) Crown Royalties**

When calculating the net revenues on which Crown royalties are based, Canadian Oil sands must determine the appropriate deductible costs. This requires the use of judgment in the application of the governing royalty agreement. It may take several years to establish the appropriate application of the royalty agreement and the final outcome of this could result in amounts different from those initially recorded and could impact Crown royalties in the period in which this is established.

**d) Taxes**

In determining its current and deferred tax provisions, Canadian Oil Sands must apply judgment when interpreting and applying complex and changing tax laws and regulations. The determination of the appropriate application of these laws and regulations by tax authorities may remain uncertain for several years. The final outcome of such determination could result in amounts different from those initially recorded and would impact current or deferred tax expense in the period in which a determination is made.

## Accounting Pronouncements Not Yet Adopted

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers,* which replaced several revenue recognition standards previously issued by the IASB. The new standard establishes principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. Application of the standard is mandatory for years beginning on or after January 1, 2017 with earlier application permitted. Canadian Oil Sands continues to assess the impact of this new standard.

## Financial Instruments

The Corporation's financial instruments include cash and cash equivalents, accounts receivable, investments held in a reclamation trust, accounts payable and accrued liabilities, and long-term debt. The carrying values and fair values of the Corporation's financial instruments are disclosed in Note 18 to the consolidated financial statements. The risks associated with these instruments and the Corporation's management of these risks is disclosed in the "Financial Market Risks" portion of the "Risk Management" section of this MD&A.

## Risk Management

Canadian Oil Sands approaches the management of risk systematically through a process designed to identify, categorize and assess risks. Syncrude Canada, as operator of Syncrude, identifies and assesses the operational and environmental, health, and safety (“EH&S”) risks that may impact its operations. The Corporation then augments Syncrude Canada’s analysis with further consideration of risks specific to Canadian Oil Sands. Risks are categorized based on their probability of occurrence and their potential impact on Canadian Oil Sands’ financial results, financial condition, corporate reputation and EH&S performance. Syncrude and Canadian Oil Sands take a number of actions once the risks have been identified and categorized, including avoidance, mitigation, risk transfer and acceptance. In addition to ongoing monitoring and review, the Board of Directors of Canadian Oil Sands is presented at least annually with a summary of management’s assessment of the risks and strategies for managing such risks. The Board of Directors reviews the assessment and recommendations, and provides oversight of this risk management process.

There are a number of risks that could impact Canadian Oil Sands’ cash flow from operations and net income and, therefore, the dividends ultimately paid to Shareholders. Cash flow from operations is sensitive to a number of factors including: Syncrude production; sales volumes; oil and natural gas prices; oil price differentials; foreign currency exchange rates; operating, development, administration and financing expenses; Crown royalties; taxes; and regulatory and environmental risks. Dividends may also be impacted by Canadian Oil Sands’ financing requirements for capital expenditures. Sensitivities to the most significant items affecting cash flow from operations are provided in the “2015 Outlook” section of this MD&A.

The following discusses the significant risks that impact Canadian Oil Sands’ cash flow from operations, net income, corporate reputation and EH&S performance. More information regarding Canadian Oil Sands’ risks is available in its AIF dated February 24, 2015, which is available on our website at **www.cdnoilsands.com** or at **www.sedar.com**.

### Crude Oil Price Risk

The financial results and financial condition of Canadian Oil Sands are significantly impacted by crude oil prices.

Prices for oil are subject to large fluctuations in response to changes in the global and regional supply and demand for oil as well as numerous other factors including: the condition of the Canadian, United States and global economies; the actions of the Organization of Petroleum Exporting Countries ("OPEC"); access to markets and sufficient pipeline and rail capacity; governmental regulation; political stability in the Middle East and elsewhere; war, or the threat of war, in oil producing regions; the domestic and foreign supply of oil and refined products; the price of foreign imports of crude oil and refined products and the availability and price of alternate fuel sources. All of these factors are beyond our control and can result in a high degree of price volatility not only in crude oil prices, but also fluctuating price differentials between heavy and light grades of crude oil and between SCO and light crude oil benchmarks such as WTI and European Brent, all of which can impact prices for SCO.

During the past three years, WTI monthly average prices have fluctuated from U.S. $107 per barrel to recent lows of U.S. $47 per barrel. This monthly average WTI benchmark has traded at discounts to monthly European Brent prices ranging from U.S. $2 per barrel to U.S. $23 per barrel over the same period. Canadian Oil Sands’ realized SCO to WTI monthly average price differential has ranged from a $10 per barrel premium to a $16 per barrel discount over the last three years.

A prolonged period of low crude oil prices could affect the value of our interest in the Syncrude Project, the level of capital investment and could ultimately result in curtailment of production. Any substantial and extended decline in our realized SCO price would have an adverse effect on Canadian Oil Sands’ cash flow from operations and would likely affect our ability to pay dividends and to repay our debt obligations. A prolonged period of low crude oil prices could also result in the impairment of Canadian Oil Sands’ assets, which would likely have a negative impact on our financial condition.

While the Syncrude Project has not been shut down for non-operational reasons since production commenced in 1978, a prolonged period of low oil prices could result in production being suspended. Any such suspension of production could expose Canadian Oil Sands to significant additional expense and would negatively impact its ability to pay dividends and repay its debt obligations. A prolonged period of low oil prices could ultimately render the Syncrude Project uneconomic.

Canadian Oil Sands prefers to remain unhedged on crude oil prices; however, during periods of significant capital spending and financing requirements, management may hedge prices to reduce cash flow volatility. Canadian Oil Sands does not currently have any crude oil price hedges in place, nor were any in place during 2014 or 2013; instead, the Corporation is managing its exposure to crude oil price risk by maintaining a strong balance sheet and ensuring adequate sources of financing are available.

## Operational Risk

***Operational outages***

Our investment in Syncrude is our only producing asset and our results depend on Syncrude's operations. The Syncrude Project is a 24-hour per day, 365-day per year operation with complex, inter-dependent facilities. The shutdown of any part of Syncrude's operation could significantly impact the production of SCO. Causes of production shortfalls and/or interruptions may include, but are not limited to: equipment failures; design errors; operator errors; extended weather-related shutdowns; or catastrophic events such as fires, storms, explosions or dam failures.

Syncrude currently has a large inventory of water stored on site and such inventory is growing annually due to the importation and required capture of water. Syncrude is developing a water management plan that involves treatment and water return. However, Syncrude has not received approval to return any water from its operation. If Syncrude is unable to return water, this may have a negative impact on the cost of its operations or its ability to operate.

The geology of the oil sands and the limestone base under the oil sands could pose the risk of underground aquifers entering and flooding the mine area, thereby reducing the amount of ore available for mining and reducing tailings storage capacity.

Syncrude's operations use electrical power generated within the Syncrude Project as well as electrical power sourced from the Alberta power grid. An interruption in either the power supply generated within Syncrude or sourced from the Alberta power grid would have a negative impact on Syncrude's production.

The Syncrude Project incorporates operational risk management programs as well as support from Imperial Oil/ExxonMobil through a Management Services Agreement ("MSA"). The MSA provides Syncrude with access to ExxonMobil's full suite of operational, environmental, health and safety systems, all of which have been implemented at Syncrude since the MSA was executed. These organizations apply robust engineering and design standards and use maintenance and inspection procedures to mitigate operational risk.

Syncrude is currently undertaking various operational optimization initiatives. In 2014, Syncrude completed improvements in mining, froth treatment and upgrading to address the root causes of previous unplanned outages. The work included the recapitalization of all of Syncrude's primary bitumen mining facilities with the relocation and refurbishment of the Aurora North mine trains in 2013 and the replacement of the Mildred Lake mine trains in 2014. In bitumen froth treatment, Syncrude retrofitted bitumen centrifuges to improve the quality of bitumen feed and increase throughput rates to the upgrader. In upgrading, Syncrude completed the replacement of heat exchangers in its hydrogen plants to prevent production losses as a result of unplanned hydrogen plant outages.

Canadian Oil Sands also reduces exposure to some operational risks by maintaining appropriate levels of insurance, primarily business interruption ("BI") and property insurance. The Corporation has purchased total coverage of approximately U.S. $1.65 billion of combined BI and property insurance, net to Canadian Oil Sands, in case Syncrude experiences an event causing a loss or interruption of production, such as a fire or explosion at the operating facilities. The BI insurance is subject to an approximate average 70-day self-retention period. While such insurance mitigates the impact of certain operational upsets, insurance is unlikely to fully protect against catastrophic events or prolonged shutdowns.

***Project execution***

There are risks associated with the execution of Syncrude's major projects and future growth and development projects. These risks include: our ability to obtain the necessary regulatory, environmental and other approvals; Syncrude's ability to successfully consult with local stakeholders and Aboriginal groups; the impact of technology on operations and processes and how new complex technology may not perform as expected; risks relating to schedule, resources and costs, including the availability and cost of materials, equipment and qualified personnel, especially skilled construction and engineering labour; the impact of general economic, business and market conditions; the impact of weather conditions; our ability to finance growth if commodity prices were to stay at low levels for an extended period; the impact of new entrants to the oil sands business which could take the form of competition for skilled people, increased demands on the Wood Buffalo Region, Alberta infrastructure (for example, housing, roads and schools) and price competition for products sold into the marketplace; and the effect of changing government regulation and public expectations in relation to the impact of oil sands development on the environment.

Syncrude's strategic planning function, whose mandate includes the identification and evaluation of capital projects, helps manage these risks with support from Imperial Oil/ExxonMobil, who provide proprietary capital project management systems under the MSA.

## Competition Risk

Syncrude faces risks associated with competition amongst other oil sands producers for limited resources, in particular skilled labour, in the Wood Buffalo Region where Syncrude and other oil sands producers operate. The demand for these resources creates cost pressure on products and services to operate, maintain and grow Syncrude's facilities. In addition, the competition for skilled labour has put pressure on recruiting, training and retaining the necessary personnel to operate Syncrude's facilities effectively and efficiently. Limitations on the availability of an experienced workforce, including high attrition rates, increases the risk of design error or operator error.

Any increase in mining and manufacturing activity causes longer procurement lead times for many materials used in the Syncrude operation. Over the last several years, Syncrude has had to place an emphasis on maintenance planning and scheduling activities, with special attention to ensuring that adequate spare parts inventories are on hand at all times. Still, certain suppliers have been challenged to keep ahead of increasing demand for maintenance and operating materials. If Syncrude cannot obtain such materials for its operations, production may be impacted and consequently, the sales volumes and cash flow from operations for Canadian Oil Sands will be negatively impacted.

The petroleum industry is highly competitive, including the distribution and marketing of petroleum products. Substantially all of our production is currently consumed by refineries in Canada and the United States for further processing into refined products. We compete for these markets against other sources of crude oil and these refineries compete against other refineries and imported refined products. The petroleum industry also competes with other industries in supplying energy, fuel and related products to consumers. The price received for SCO or our ability to deliver SCO may be limited with negative implications on revenues and cash flow from operations if (i) supply of crude oil or refined products increases, (ii) North American and/or global demand for crude oil or products decreases, or (iii) if planned or unplanned shutdowns of refineries generally or of refineries that process SCO occurs.

To mitigate the risk of competition for skilled labour, Syncrude Canada is focused on attracting and retaining experienced and skilled labour. Syncrude Canada offers competitive industry compensation to employees and contract staff and has employee retention and housing programs to deal with the increased demands on local infrastructure. As well, Syncrude's reputation as a socially and environmentally responsible company with industry-leading safety performance supports the company in attracting and retaining labour. Lastly, Syncrude Canada's Management Services Agreement with Imperial Oil enables Syncrude to access people and expertise from Imperial Oil and its affiliates, including ExxonMobil.

To mitigate other competitive risks that could increase operating, development and capital costs, Syncrude formed a Cost Analysis and Strategy Taskforce in 2014 to identify more efficient and effective ways to conduct its business.The aim is to reduce the cost structure at Syncrude and improve profitability.

## Marketing and Transportation Risk

All of our Syncrude production is transported through the AOSPL pipeline system, which delivers SCO from the Syncrude plant site to Edmonton, Alberta. The AOSPL pipeline system feeds into various other crude oil pipelines that are used to deliver SCO to refinery customers within Canada and the United States. Lack of sufficient pipeline capacity or interruptions in pipeline operations could result in apportionment of volumes and therefore adversely impact our crude oil production, sales volumes and/or the prices received for SCO. These may be caused by the inability of a pipeline to operate, or they can be related to capacity constraints as the supply of crude oil into the system exceeds the infrastructure capacity. In addition, if the AOSPL pipeline system is unable to ship SCO for an extended period of time this would result in the curtailment or shut-down of production at Syncrude, which would have a material adverse effect on the business and financial condition of Canadian Oil Sands.

Crude oil supply growth, downstream operational incidents and increased maintenance and integrity programs have led to apportionment of volumes on certain pipelines over the past number of years. Apportionment has restricted our ability to reach preferred markets and adversely impacted our price realizations. A number of projects to build new pipelines, or expand and extend existing pipelines, are currently planned with significant new capacity projected to be available over the coming years. There can be no certainty, however, that investments will be made or that regulatory approvals will be received to provide this capacity or that current capacity will not encounter operational incidents. In addition, planned or unplanned shutdowns, reduced processing rates or closures of our refinery customers may limit our ability to deliver SCO.

Pipeline and rail access and capacity, transportation costs and tariffs, market access and price differentials with competing products are all factors that can affect sales volumes and the realized selling price for SCO. As crude oil production rises and traditional light crude oil refineries finalize projects to refine heavy and sour crudes, we anticipate some of our SCO will be consumed at more distant delivery points. Pipeline transportation costs will rise, and COS' price realization may be negatively impacted by these costs as well as supply and demand factors in these markets. As a result, our realized selling price for SCO may be negatively impacted in the future.

Canadian Oil Sands has committed capacity on a number of proposed pipelines to help secure future market access for our product and enhance our marketing flexibility. We have also secured storage capacity in the Edmonton area and have entered term sales agreements with customers in new markets. As of December 31, 2014, we have commitments on take-or-pay contracts totaling approximately $2.3 billion due over the next 24 years for the transportation and storage of crude oil.

## Environmental Risks

Canadian Oil Sands is committed to ensuring that Syncrude develops its oil sands reserves and resources in a responsible way. We are subject to laws and regulations governing the impact Syncrude and other oil sands operations have on the environment. Additionally, we are subject to reputational risk regarding such environmental impacts. The following highlights the key environmental risks at this time:

**a) Tailings Management**

Syncrude produces a significant volume of fluid fine tailings, which are presently held in settling basins. Syncrude's closure and reclamation plan and its Alberta Energy Regulator ("AER") approval depends on the use of composite tails, centrifuge and end pit lakes technology to manage tailings fluids and solids associated with bitumen production. There is an inherent risk that such technologies used by Syncrude may not be as effective as desired or perform as required in order to meet the approved closure and reclamation plan, Directive 074 (Tailings Performance Criteria and Requirements for Oil Sands Mining Schemes of the AER) or the Tailings Management Framework ("TMF") being developed by Alberta Environment and Sustainable Resource Development.

Directive 074 allows the AER to take enforcement action against companies that fail to meet industry-wide tailings management criteria. Enforcement actions range from non-compliance fees to increased inspections and suspension or cancellation of approvals. Directive 074 is performance-based, and gives companies the flexibility to select the technology most applicable to their operation in order to achieve the performance criteria. The TMF, which is anticipated to be finalized in 2015, will be an overarching framework to manage all aspects of tailings including: volume of fluid fine tails, size of tailings ponds, greenhouse gas impact, water use/re-use/return; progressive reclamation and the use of research and development. The details of the TMF are not yet known.

While Syncrude continues to develop tailings and fluid fine tailings reclamation technologies, there is a risk of increased costs to develop and implement various measures, the potential for tailings specific regulatory approval conditions to be attached to future regulatory applications and/or renewals and a risk that Syncrude's approvals could be suspended or cancelled if it cannot comply with the requirements of Directive 074 or the TMF once it is finalized, all of which could have a material adverse effect on Canadian Oil Sands' business and financial condition.

**b) Water Access and Emissions**

Syncrude operations involve the use of water and create emissions such as sulphur dioxide and carbon dioxide. Legislation which significantly restricts or penalizes water use and/or emissions may have a material impact on our operations. No assurance can be given that existing or future environmental regulations will not adversely impact the ability of the Syncrude Project to operate at present levels or increase production, or that such regulations will not result in higher unit costs of production.

Through Canada's Oil Sands Innovation Alliance (COSIA), Syncrude is collaborating with other oil sands producers to enable responsible and sustainable growth while delivering accelerated improvement in environmental performance through collaborative action and innovation. This will involve sharing technical information, collaborating on research and development, eliminating monetary and intellectual property barriers and working to develop appropriate frameworks so that information is organized, kept current and verified through peer review.

## Syncrude Joint Venture Ownership Risk

Syncrude is a joint venture currently owned by seven participants. Each participant is entitled to one vote. Operating decisions and those relating to debottlenecking matters require a 51 per cent majority with at least three participants' approving while major growth decisions outside of the original scope of the operations as well as product quality changes require unanimous approval. Syncrude's future plans will depend on such agreement and may depend on the financial strength and views of the other participants at the time such decisions are made. The other participants may have objectives and interests that do not coincide with and may conflict with Canadian Oil Sands' interests.

## FInancial Market Risks

Canadian Oil Sands is subject to financial market risk as a result of fluctuations in foreign currency rates, interest rates, credit risks and liquidity.

### a) Foreign Currency Risk

Canadian Oil Sands' results are affected by fluctuations in the U.S./Canadian currency exchange rates as our sales are based in part on a WTI benchmark price in U.S. dollars, while operating expenses and capital expenditures are primarily in Canadian dollars. During 2014 and 2013, the U.S. to Canadian dollar exchange rate has ranged from a low of $0.86 U.S./Cdn to a high of $1.02 U.S./Cdn. Our sales exposure is partially offset by our U.S. dollar crude oil purchases, our share of Syncrude's U.S. dollar operating and capital costs, interest costs on U.S. dollar denominated long-term debt and, in periods when our U.S. dollar denominated long-term debt matures, the principal repayments.

Canadian Oil Sands prefers to remain unhedged on foreign currency and did not have any foreign currency hedges in place in 2014 or 2013; however, the Corporation may hedge foreign currency rates in the future depending on the business environment and growth opportunities.

As at December 31, 2014, portions of Canadian Oil Sands' cash and cash equivalents, accounts receivable, accounts payable and long-term debt were denominated in U.S. dollars. Based on these U.S. dollar closing balances, 2014 net income and comprehensive income would have increased/decreased by approximately $20 million for every $0.01 decrease/increase in the value of the U.S./Cdn currency exchange rate.

### b) Interest Rate Risk

Canadian Oil Sands is exposed to interest rate risk as changes in market interest rates may affect the Corporation's financial results and financial condition.

The principal exposure relates to the Corporation's long-term debt, in particular the refinancing of our fixed rate long-term debt on maturity or, to the extent there are amounts drawn, our variable-rate credit facilities. The next Senior Note maturity is in 2019 and, at December 31, 2014, $140 million was drawn on the credit facilities. The interest rate the Corporation pays on its long-term debt is also impacted by its credit ratings.

Changes in interest rates also impact the Corporation's short-term investments, which are continually reinvested with maturities of less than 90 days, our obligation for employee future benefits and our asset retirement obligation. Changes in interest rates impact the carrying value of the accrued benefit liability as well as the ongoing interest costs, current service costs and cash funding of our employee future benefits. Interest rates also impact the carrying value of the asset retirement obligation and the related accretion and depreciation and depletion expenses.

Additional information about interest rate sensitivity for the Corporation's employee future benefits is provided in the "Critical Accounting Estimates and Judgments" section of this MD&A.

### c) Credit Risk

Canadian Oil Sands is exposed to credit risk primarily through customer accounts receivable balances, financial counterparties with whom the Corporation has invested its cash and cash equivalents and with its insurance providers in the event of an outstanding claim.

The maximum exposure to any one customer or financial counterparty is managed through a credit policy that limits exposure based on credit ratings. The policy also specifically limits the aggregate exposure to customers with a credit rating below investment grade to a maximum of 25 per cent of Canadian Oil Sands' consolidated accounts receivable. This credit risk concentration is monitored on a regular basis. Risk is further mitigated as accounts receivable with customers typically are settled in the month following the sale, and investments with financial counterparties are typically short-term in nature and are placed with institutions that have a credit rating of "R-1 (low)" or better, as defined by the Dominion Bond Rating Service ("DBRS").

Canadian Oil Sands carries credit insurance on some counterparties to help mitigate a portion of the impact should a loss occur and continues to transact primarily with investment-grade customers. The Corporation's maximum credit exposure related to customer receivables was $185 million at December 31, 2014, all of which were paid in January 2015. Substantially all accounts receivable are due from investment grade energy producers, financial institutions, and refinery-based customers, and our cash and cash equivalents are invested in deposits and bankers' acceptances with high-quality senior banks as well as investment grade commercial paper. At present, there are no financial assets that are past their maturity or impaired due to credit risk-related defaults.

**d) Liquidity Risk**

Liquidity risk is the risk that Canadian Oil Sands will not be able to meet its financial obligations as they become due and is impacted by: the amount and timing of operating commitments, future capital expenditure requirements and debt repayments as well as the adequacy of financing available through bank credit facilities or debt and equity capital markets. In addition, a downgrade in the Corporation's credit ratings may impact the cost of and our ability to access financing, and may require the Corporation to provide financial security under certain transportation and storage contracts.

The ability to make scheduled payments on or to refinance debt obligations depends on the financial condition and operating performance of the Corporation, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond its control. Volatility in the credit markets may increase costs associated with debt instruments due to increased spreads over relevant interest rate benchmarks, or affect the Corporation's, or third parties that the Corporation seeks to do business with, ability to access those markets. The Corporation may be unable to maintain a level of cash flow from operations sufficient to permit it to pay the principal, premium, if any, and interest on its indebtedness. In addition, there may be volatility in the capital markets and access to financing, although currently available, can be uncertain. These conditions could have an adverse effect on the industry in which the Corporation operates and its business, including future operating and financial results.

Canadian Oil Sands actively manages its liquidity through cash, debt and equity management strategies. Such strategies encompass, among other factors: having adequate sources of financing available through bank credit facilities, estimating future cash flow from operations based on reasonable production and pricing assumptions, understanding operating commitments and future capital expenditure requirements and complying with debt covenants. In addition, over the long-term, Canadian Oil Sands spreads out the maturities of its various debt tranches, maintains a prudent capital structure and is in compliance with its debt covenants.

More information regarding the available credit facilities and contractual maturities of Canadian Oil Sands' long-term debt can be found in Note 10 to the consolidated financial statements.

## Actual Results Compared to Outlook

In its 2013 annual MD&A, Canadian Oil Sands estimated 2014 Syncrude production volumes, cash flow from operations and capital expenditures (the “original estimate” or “original Outlook”). During 2014 the Corporation revised these estimates in quarterly reports and information releases to reflect actual results for each quarter and new significant information as it became available (the “revised estimate” or “revised Outlook”).

| | 2014 Outlook | | |
|---|---|---|---|
| *(millions of Canadian dollars, unless noted otherwise)* | **Original[1]** | **Revised[2]** | **2014 Actual** |
| **Operating assumptions** | | | |
| Syncrude production (million bbls) | 105 | 97 | 94 |
| Canadian Oil Sands sales (million bbls) | 38.6 | 35.6 | 34.5 |
| Sales, net of crude oil purchases and transportation | $ 3,386 | $ 3,634 | $ 3,419 |
| Realized SCO selling price ($/bbl) | $ 87.77 | $ 101.97 | $ 99.24 |
| Operating expenses | $ 1,600 | $ 1,668 | $ 1,686 |
| Operating expenses per barrel ($/bbl) | $ 41.48 | $ 46.80 | $ 48.86 |
| Development expenses | $ 181 | $ 148 | $ 150 |
| Crown royalties | $ 128 | $ 260 | $ 221 |
| Current taxes | $ 200 | $ 180 | $ 172 |
| Cash flow from operations[3] | $ 1,158 | $ 1,272 | $ 1,106 |
| **Capital expenditure assumptions** | | | |
| Major projects | $ 653 | $ 575 | $ 562 |
| Regular maintenance | $ 361 | $ 260 | $ 257 |
| Capitalized interest | $ 83 | $ 103 | $ 111 |
| Total capital expenditures | $ 1,097 | $ 938 | $ 930 |
| **Business environment assumptions** | | | |
| Sales Weighted Average WTI Crude Oil (USD/bbl) | $ 90.00 | $ 95.00 | $ 92.91 |
| Sales Weighted Average Premium/Discount to CAD WTI ($/bbl) | $ (5.00) | $ (2.50) | $ (2.55) |
| Sales Weighted Average Foreign Exchange Rate (CAD:USD) | $ 0.97 | $ 0.91 | $ 0.91 |
| Average AECO Natural Gas (CAD/GJ) | $ 3.50 | $ 4.50 | $ 4.27 |

*[1]Original 2014 Outlook as provided in the 2013 annual report dated February 20, 2014.*
*[2]Revised 2014 Outlook as provided in the third quarter 2014 quarterly report dated October 30, 2014.*
*[3]Cash flow from operations is an additional GAAP financial measure and is defined in the “Additional GAAP Financial Measures” section of this MD&A.*

Cash flow from operations in 2014 was $1,106 million, $52 million lower than the original estimate, mainly reflecting lower sales volumes, higher Crown royalties and higher operating expenses. Partially offsetting these impacts was a higher-than-forecast realized SCO selling price.

Syncrude 2014 production of 94 million barrels was lower than Canadian Oil Sands’ 105 million barrel original estimate, due to unplanned outages on Coker 8-1, sulphur processing units and a sour water treatment unit. Canadian Oil Sands’ sales volumes in 2014 totalled 34.5 million barrels, or 94,600 barrels per day.

Crown royalties were $221 million in 2014, $93 million higher than the original estimate. A higher-than-forecast WTI price and a narrowing of the heavy oil differentials in the second half of 2014 resulted in higher deemed bitumen values used to calculate Crown royalties.

Operating expenses of $1,686 million were $86 million higher than our original estimate, reflecting higher-than-expected maintenance costs on upgrading units and higher-than-forecast natural gas prices. Per-barrel operating expenses of $48.86 were 18 per cent higher than the original estimate mainly as a result of lower-than-forecast sales volumes.

The realized selling price in 2014 averaged $99.24 per barrel, $11 per barrel higher than the original estimate, reflecting a U.S. $3 per barrel higher WTI oil price, a smaller discount to Canadian dollar WTI and a weaker Canadian dollar.

Current taxes were $172 million in 2014, approximately $30 million below the original estimate on lower than expected net income.

Capital expenditures in 2014 were $930 million, 15 per cent lower than our original estimate, reflecting active management of regular maintenance projects and cost savings on the Mildred Lake Mine Train Replacement project.

## 2015 Outlook

| *(millions of Canadian dollars, unless noted otherwise)* | | **As of February 24, 2015** |
|---|---|---|
| **Operating assumptions** | | |
| Syncrude production (million bbls) | | 103 |
| Canadian Oil Sands sales (million bbls) | | 37.8 |
| Sales, net of crude oil purchases and transportation | $ | 2,387 |
| Realized SCO selling price ($/bbl) | $ | 63.08 |
| Operating expenses | $ | 1,521 |
| Operating expenses per barrel ($/bbl) | $ | 40.19 |
| Development expenses | $ | 151 |
| Crown royalties | $ | 119 |
| Current taxes | $ | 65 |
| Cash flow from operations[1] | $ | 368 |
| **Capital expenditure assumptions** | | |
| Major projects | $ | 104 |
| Regular maintenance | $ | 315 |
| Capitalized interest | $ | 32 |
| Total capital expenditures | $ | 451 |
| **Business environment assumptions** | | |
| Sales Weighted Average WTI Crude Oil (USD/bbl) | $ | 55.00 |
| Sales Weighted Average Premium/Discount to CAD WTI ($/bbl) | $ | (4.00) |
| Sales Weighted Average Foreign Exchange Rate (CAD:USD) | $ | 0.82 |
| Average AECO Natural Gas (CAD/GJ) | $ | 3.00 |

*[1] Cash flow from operations is an additional GAAP financial measure and is defined in the "Additional GAAP Financial Measures" section of this MD&A.*

The amounts in this 2015 Outlook dated February 24, 2015 are unchanged from the 2015 Outlook dated January 29, 2015, which was provided in the fourth quarter 2014 report.

Canadian Oil Sands estimates annual Syncrude production of 95 to 110 million barrels for 2015. For the purpose of generating our 2015 Outlook, we have selected a single-point production estimate of 103 million barrels (282,200 barrels per day). Net to Canadian Oil Sands, the single-point estimate is equivalent to 37.8 million barrels (103,600 barrels per day). The production estimate reflects a planned turnaround of Coker 8-3 in the second quarter of the year.

In response to the current price environment, Syncrude is undertaking a comprehensive review of its costs. An effort was underway at Syncrude to reduce the cost structure, but this work has intensified in recent weeks to identify near-term opportunities. The initial efforts have identified potential cost reductions in 2015 of $160 million to $250 million in operating and development expenses and $100 million to $150 million in capital expenditures, net to COS, relative to the budget issued on December 3, 2014. COS has incorporated $294 million of these potential cost reductions in its 2015 Outlook. Syncrude does not anticipate these reductions to have an impact on health and safety, production or reliability initiatives.

Changes in certain factors and market conditions could potentially impact Canadian Oil Sands' Outlook. The following table provides a sensitivity analysis of the key factors affecting the Corporation's performance.

### Outlook Sensitivity Analysis (February 24, 2015)

| Variable | **Annual Sensitivity** | **Cash Flow from Operations Increase[3]** **$ millions[1,2]** | **$ / Share[1,2]** |
|---|---|---|---|
| WTI crude oil price increase | USD $1.00/bbl | $ 29 | $ 0.06 |
| Syncrude production increase | 1 million bbls | $ 14 | $ 0.03 |
| Canadian dollar weakening | $0.01 CAD:USD | $ 19 | $ 0.04 |
| Syncrude operating expense decrease | $1.00/bbl | $ 23 | $ 0.05 |
| Syncrude operating expense decrease | $100 million | $ 22 | $ 0.05 |
| AECO natural gas price decrease | $0.50/GJ | $ 13 | $ 0.03 |

*[1] These sensitivities are after the impact of taxes.*

*[2] These sensitivities assume Canadian Oil Sands pays Crown royalties based on 25% of net deemed bitumen revenues.*

*[3] An opposite change in each of these variables will result in the opposite cash flow from operations impact.*

*The 2015 Outlook contains forward-looking information and users are cautioned that the actual amounts may vary from the estimates disclosed. Please refer to the "Forward-Looking Information Advisory" section of this MD&A for the risks and assumptions underlying this forward-looking information.*

## Major Projects

The Mildred Lake Mine Train Replacement project was completed in 2014 at a total cost of $3.8 billion ($1.4 billion net to Canadian Oil Sands), a savings of $400 million relative to the original budget of $4.2 billion. The newly constructed mine trains are operational and are expected to increase processing capacity, improve reliability and reduce maintenance costs.

The Centrifuge Tailings Management project is now 97% complete, with final completion expected in 2015. The project continues to remain on budget with a cost estimate at $1.9 billion ($0.7 billion net to Canadian Oil Sands) and an estimated cost accuracy of +2%/-5%. This project is expected to accelerate the pace of tailings treatment to meet regulatory requirements.

With the completion of the major project program, Syncrude will have the infrastructure to produce the remaining ore at its two operating mines and improve its tailings management performance, as well as support new ore production from the MLX project once approved.

## Controls Environment

Management is responsible for establishing and maintaining adequate internal control over financial reporting. We have established disclosure controls and procedures, internal control over financial reporting, and organization-wide policies to provide reasonable assurance that Canadian Oil Sands' consolidated financial position, financial performance and cash flows are presented fairly. Our disclosure controls and procedures are designed to provide reasonable assurance of the timely disclosure and communication of all material information.

We periodically review and update our internal control systems to reflect changes in our business environment. We did not materially change any of our internal controls during 2014.

All internal control systems, no matter how well designed, have inherent limitations. These systems, therefore, provide reasonable but not absolute assurance that financial information is accurate and complete.

Canadian Oil Sands, under the supervision and participation of management, including the President and Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures and the design of our internal control over financial reporting pursuant to National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* as of December 31, 2014. In addition, management has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2014 using criteria established in *Internal Control - Integrated Framework* issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission. Based on these evaluations, Canadian Oil Sands' management concluded that:

- Our disclosure controls and procedures were effective as of December 31, 2014 to provide reasonable assurance that material information is recorded, processed, summarized and reported within the time periods specified by the applicable Canadian securities regulators. Furthermore, our disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed under applicable Canadian securities regulation is communicated to our management, including our President and Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure; and
- Our internal control over financial reporting as of December 31, 2014 was designed and operated effectively to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external purposes in accordance with GAAP.

PricewaterhouseCoopers LLP, our auditors, have expressed an unqualified opinion on the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2014, as stated in their report.

# Management's Report

**Financial Information**

Management is responsible for the information contained in this annual report. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles, and include amounts based on management's informed judgments and estimates. Where alternative accounting methods exist, management has chosen those that it deems to be the most appropriate based on Canadian Oil Sands' operations. The financial and operating information included in this annual report is consistent with that contained in the Consolidated Financial Statements in all material respects.

To assist management in fulfilling its responsibilities, systems of accounting, internal controls and disclosure controls are maintained to provide reasonable, but not absolute, assurance that financial information is reliable and accurate and that assets are adequately safeguarded. In addition, Canadian Oil Sands has in place a Code of Business Conduct that applies to all of its employees and directors.

PricewaterhouseCoopers LLP, Chartered Accountants, appointed annually by the Shareholders to serve as Canadian Oil Sands' external auditors, were engaged to conduct an examination of the Consolidated Financial Statements and internal controls in accordance with Canadian generally accepted auditing standards and in accordance with the standards of the Public Company Accounting Oversight Board (United States), and have expressed their opinion on these statements. Canadian Oil Sands also engages independent reserve evaluators to conduct independent evaluations of its crude oil reserves and resources. The external auditors and reserve evaluators have unrestricted access to the management of Canadian Oil Sands, the Audit Committee, the Reserves, Marketing Operations, and Environmental, Health and Safety Committee and the Board of Directors.

The Board of Directors has appointed a four-person Audit Committee, consisting of directors who are neither employees nor officers of Canadian Oil Sands and all of whom are independent. The Audit Committee meets regularly with management and external auditors to discuss controls over the financial reporting process, auditing and other financial reporting matters. In addition, it recommends the appointment of Canadian Oil Sands' external auditors. The Audit Committee meets at least quarterly with management and the external auditors to review and recommends approval of the interim financial statements and the audited annual financial statements to the Board of Directors. Quarterly, the Board of Directors reviews and approves the interim unaudited financial statements. Annually, the Board of Directors reviews and approves Canadian Oil Sands' audited annual financial statements, Management's Discussion and Analysis, Annual Information Form, Management Proxy Circular and annual reserves and resources estimates. The Board of Directors has approved the annual audited Consolidated Financial Statements and the Management's Discussion and Analysis based on the recommendations of the Audit Committee.

**Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting.

Management has assessed the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2014 using criteria established in the *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on this evaluation, management concluded that Canadian Oil Sands' internal control over financial reporting was effective as of December 31, 2014.

PricewaterhouseCoopers LLP, our external auditors, has audited the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2014 as stated in their report which appears herein.

(signed) **Ryan M. Kubik**
President and Chief Executive Officer
February 24, 2015

(signed) **Robert P. Dawson**
Chief Financial Officer
February 24, 2015

February 24, 2015

**Independent Auditor's Report**

**To the Shareholders of**
**Canadian Oil Sands Limited**

We have completed integrated audits of Canadian Oil Sands Limited's 2014 and 2013 consolidated financial statements and its internal control over financial reporting as at December 31, 2014. Our opinions, based on our audits are presented below.

**Report on the consolidated financial statements**
We have audited the accompanying consolidated financial statements of Canadian Oil Sands Limited, which comprise the consolidated balance sheets as at December 31, 2014 and 2013 and the consolidated statements of income and comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

**Management's responsibility for the consolidated financial statements**
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. Canadian generally accepted auditing standards also require that we comply with ethical requirements. An audit involves performing procedures to obtain audit evidence, on a test basis, about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting principles and policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion on the consolidated financial statements.

**Opinion**
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Canadian Oil Sands Limited as at December 31, 2014 and 2013 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

**Report on internal control over financial reporting**
We have also audited Canadian Oil Sands Limited's internal control over financial reporting as at December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

**Management's responsibility for internal control over financial reporting**
Management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report.

**Auditor's responsibility**
Our responsibility is to express an opinion on Canadian Oil Sands Limited's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control, based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances.

We believe that our audit provides a reasonable basis for our audit opinion on the company's internal control over financial reporting.

**Definition of internal control over financial reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

**Inherent limitations**

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

**Opinion**

In our opinion, Canadian Oil Sands Limited maintained, in all material respects, effective internal control over financial reporting as at December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

(signed) **PricewaterhouseCoopers LLP**
**Chartered Accountants**
Calgary, Alberta
February 24, 2015

# Consolidated Statements of Income and Comprehensive Income

| For the years ended December 31 *(millions of Canadian dollars, except per Share and Share volume amounts)* | | **2014** | | **2013** |
|---|---|---|---|---|
| Sales | **$** | **3,912** | $ | 4,208 |
| Crown royalties | | **(221)** | | (174) |
| **Revenues** | **$** | **3,691** | $ | 4,034 |
| | | | | |
| **Expenses** | | | | |
| Operating | **$** | **1,686** | $ | 1,494 |
| Development | | **150** | | 133 |
| Crude oil purchases and transportation | | **493** | | 643 |
| Administration | | **25** | | 30 |
| Insurance | | **11** | | 11 |
| Depreciation and depletion (Note 6) | | **514** | | 478 |
| | **$** | **2,879** | $ | 2,789 |
| **Earnings from operating activities** | **$** | **812** | $ | 1,245 |
| Foreign exchange loss (Note 15) | | **134** | | 88 |
| Net finance expense (Note 16) | | **47** | | 44 |
| **Earnings before taxes** | **$** | **631** | $ | 1,113 |
| Tax expense (Note 8) | | **171** | | 279 |
| **Net income** | **$** | **460** | $ | 834 |
| **Other comprehensive income (loss), net of taxes** | | | | |
| Items not reclassified to net income: | | | | |
| Re-measurements of employee future benefit plans (Note 9) | | **(17)** | | 61 |
| Items reclassified to net income: | | | | |
| Derivative gains | | **(3)** | | (3) |
| **Comprehensive income** | **$** | **440** | $ | 892 |
| | | | | |
| **Weighted average Shares** (millions) | | **485** | | 485 |
| **Shares, end of year** (millions) | | **485** | | 485 |
| | | | | |
| **Net income per Share (Note 13)** | | | | |
| Basic and diluted | **$** | **0.95** | $ | 1.72 |

*See Notes to Consolidated Financial Statements*

# Consolidated Statements of Shareholders' Equity

| For the years ended December 31 *(millions of Canadian dollars)* | 2014 | 2013 |
|---|---|---|
| **Retained earnings** | | |
| Balance, beginning of year | **$ 2,040** | $ 1,823 |
| Net income | **460** | 834 |
| Re-measurements of employee future benefit plans | **(17)** | 61 |
| Dividends | **(678)** | (678) |
| Balance, end of year | **$ 1,805** | $ 2,040 |
| **Accumulated other comprehensive income** | | |
| Balance, beginning of year | **$ 6** | $ 9 |
| Reclassification of derivative gains to net income | **(3)** | (3) |
| Balance, end of year | **$ 3** | $ 6 |
| **Shareholders' capital** | | |
| Balance, beginning of year | **$ 2,674** | $ 2,673 |
| Issuance of shares | **1** | 1 |
| Balance, end of year | **$ 2,675** | $ 2,674 |
| **Contributed surplus** | | |
| Balance, beginning of year | **$ 12** | $ 10 |
| Share-based compensation | **2** | 2 |
| Balance, end of year | **14** | 12 |
| **Total Shareholders' equity** | **$ 4,497** | $ 4,732 |

*See Notes to Consolidated Financial Statements*

# Consolidated Balance Sheets

| As at December 31 *(millions of Canadian dollars)* | | 2014 | | 2013 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets | | | | |
| Cash and cash equivalents | **$** | **33** | $ | 806 |
| Accounts receivable | | **185** | | 369 |
| Inventories (Note 5) | | **188** | | 163 |
| Current taxes (Note 8) | | **17** | | — |
| Prepaid expenses | | **9** | | 8 |
| | **$** | **432** | $ | 1,346 |
| Property, plant and equipment, net (Note 6) | | **9,441** | | 8,712 |
| Exploration and evaluation | | **54** | | 54 |
| Reclamation trust (Note 11) | | **87** | | 78 |
| | **$** | **10,014** | $ | 10,190 |
| **Liabilities and Shareholders' Equity** | | | | |
| Current liabilities | | | | |
| Accounts payable and accrued liabilities (Note 7) | **$** | **487** | $ | 786 |
| Current taxes (Note 8) | | **—** | | 259 |
| Current portion of employee future benefits (Note 9) | | **20** | | 82 |
| | **$** | **507** | $ | 1,127 |
| Deferred taxes (Note 8) | | **1,527** | | 1,535 |
| Employee future benefits (Note 9) | | **318** | | 226 |
| Long-term debt (Note 10) | | **1,889** | | 1,602 |
| Asset retirement obligation (Note 11) | | **1,201** | | 868 |
| Other liabilities (Note 12) | | **75** | | 100 |
| | **$** | **5,517** | $ | 5,458 |
| Shareholders' equity (Note 13) | | **4,497** | | 4,732 |
| | **$** | **10,014** | $ | 10,190 |

Commitments, Contingencies and Guarantees (Notes 20, 21 and 22, respectively)

*See Notes to Consolidated Financial Statements*

Approved by the Board of Directors

(signed) **Wesley R. Twiss**
Director

(signed) **Donald J. Lowry**
Director

## Consolidated Statements of Cash Flows

| For the years ended December 31 *(millions of Canadian dollars)* | 2014 | 2013 |
|---|---|---|
| **Cash from (used in) operating activities** | | |
| Net income | **$ 460** | $ 834 |
| Adjustments to reconcile net income to cash flow from operations: | | |
| Depreciation and depletion | **514** | 478 |
| Accretion of asset retirement obligation (Note 11) | **28** | 26 |
| Foreign exchange loss on long-term debt (Note 15) | **145** | 115 |
| Deferred taxes (Note 8) | **(1)** | (18) |
| Share-based compensation | **(2)** | 5 |
| Reclamation expenditures (Note 11) | **(18)** | (42) |
| Change in employee future benefits and other | **(20)** | (51) |
| Cash flow from operations | **$ 1,106** | $ 1,347 |
| Change in non-cash working capital (Note 23) | **(361)** | 236 |
| Cash from operating activities | **$ 745** | $ 1,583 |
| **Cash from (used in) financing activities** | | |
| Drawdown of bank credit facilities (Note 10) | **$ 140** | $ — |
| Repayment of senior notes (Note 10) | **—** | (310) |
| Issuance of shares (Note 13) | **1** | — |
| Dividends | **(678)** | (678) |
| Cash used in financing activities | **$ (537)** | $ (988) |
| **Cash from (used in) investing activities** | | |
| Capital expenditures | **$ (930)** | $ (1,342) |
| Reclamation trust funding | **(9)** | (9) |
| Change in non-cash working capital (Note 23) | **(42)** | (2) |
| Cash used in investing activities | **$ (981)** | $ (1,353) |
| **Foreign exchange gain on cash and cash equivalents held in foreign currency** | **$ —** | $ 11 |
| **Decrease in cash and cash equivalents** | **$ (773)** | $ (747) |
| **Cash and cash equivalents, beginning of year** | **806** | 1,553 |
| **Cash and cash equivalents, end of year** | **$ 33** | $ 806 |
| **Cash and cash equivalents consist of:** | | |
| Cash | **$ 33** | $ 639 |
| Short-term investments | **—** | 167 |
| | **$ 33** | $ 806 |

**Supplementary Information** (Note 23)

*See Notes to Consolidated Financial Statements*

# Notes to Consolidated Financial Statements

*(Tabular amounts expressed in millions of Canadian dollars, except where otherwise noted)*

## 1) Nature of Operations

Canadian Oil Sands Limited ("Canadian Oil Sands" or the "Corporation") is incorporated under the laws of the Province of Alberta, Canada. The Corporation indirectly owns a 36.74 per cent interest ("Working Interest") in the Syncrude Joint Venture ("Syncrude"). Syncrude is involved in the mining and upgrading of bitumen from oil sands near Fort McMurray in northern Alberta. The Syncrude Project is comprised of open-pit oil sands mines, utilities plants, bitumen extraction plants and an upgrading complex that processes bitumen into Synthetic Crude Oil ("SCO"). Syncrude is jointly controlled by seven owners and each owner takes its proportionate share of production in kind, and funds its share of Syncrude's operating, development and capital costs on a daily basis. The Corporation also indirectly owns 36.74 per cent of the issued and outstanding shares of Syncrude Canada Ltd. ("Syncrude Canada"). Syncrude Canada operates Syncrude on behalf of the owners and is responsible for selecting, compensating, directing and controlling Syncrude's employees, and for administering all related employment benefits and obligations. The Corporation's investment in Syncrude and Syncrude Canada represents its only producing asset.

The Corporation's office is located at the following address: 2000 First Canadian Centre, 350 – 7th Avenue S.W., Calgary, Alberta, Canada T2P 3N9.

## 2) Basis of Presentation

These audited consolidated financial statements are prepared and reported in Canadian dollars in accordance with Canadian generally accepted accounting principles as set out in Part 1 of the Chartered Professional Accountants of Canada Handbook and in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and effective on February 24, 2015.

These audited consolidated financial statements were approved by the Corporation's Board of Directors and authorized for issue on February 24, 2015.

## 3) Accounting Policies

**Consolidation**

The consolidated financial statements include the accounts of the Corporation and its subsidiaries (collectively "Canadian Oil Sands"). The Corporation's subsidiaries include incorporated and unincorporated entities, such as partnerships, for which the Corporation has the power to govern financial and operating policies. All intercompany transactions and balances are eliminated on consolidation.

Activities of Syncrude and Syncrude Canada are conducted through a joint operation and, accordingly, these financial statements reflect only Canadian Oil Sands' proportionate interest in such activities, which include SCO production, Crown royalties, operating and development expenses, as well as a proportionate interest in Syncrude's property, plant and equipment, inventories, employee future benefits, other liabilities, asset retirement obligation, and associated accounts payable and receivable.

**Cash and Cash Equivalents**

Cash and cash equivalents include cash in banks and short-term investments with maturities of less than 90 days at purchase.

**Inventories**

Inventories are comprised of product inventory and materials and supplies. Product inventory includes gas oils, in-transit batches of crude oil and pipeline linefill. All inventories are carried at the lower of average cost and net realizable value. Costs include direct and indirect expenditures incurred in bringing an item or product to its existing condition and location. The costs of product inventories are recognized as operating expenses or crude oil purchases and transportation expenses when sold. The costs of materials and supplies inventories are recognized as either operating expenses or property, plant and equipment when consumed.

**Property, Plant and Equipment**

Property, plant and equipment ("PP&E") assets are recorded at cost less accumulated depreciation and depletion. The cost of a PP&E asset includes its acquisition, development and construction costs, costs directly attributable to bringing the asset into operation, the cost of initial overburden removal and the estimate of any asset retirement costs. Major turnaround costs are capitalized, while non-major turnaround costs, repairs and maintenance and ongoing overburden removal on producing oil sands mines are expensed as operating expenses in the period incurred.

Interest costs attributable to the acquisition or construction of qualifying assets, which require a substantial period of time to prepare for their intended use, are capitalized as PP&E. All other interest costs are recognized as net finance expense in the period in which they are incurred.

PP&E is depreciated on a straight-line basis over the estimated useful lives of the assets, with the exception of mine development and asset retirement costs, which are depleted on a unit-of-production basis over the estimated proved and probable reserves of the producing mines. The following estimated useful lives of the assets depreciated on a straight-line basis are reviewed annually for any changes to those estimates:

| Category | Estimated Useful Life |
|---|---|
| Major turnarounds | 2 to 3 years |
| Vehicles and equipment | 5 to 20 years |
| Mining equipment | Lesser of 25 years and the remaining life of the mine |
| Upgrading and extraction | 25 years |
| Buildings | 20 to 40 years |

Construction in progress consists of assets that are not available for use and are therefore not depreciated. Once these assets are substantially complete and ready for their intended use, their costs, including applicable capitalized interest costs, are transferred to the appropriate category of PP&E and depreciated accordingly.

**Exploration and Evaluation**

Exploration and evaluation ("E&E") assets include the costs of acquiring undeveloped oil sands leases ("oil sands lease acquisition costs") and interests in natural gas licenses located in the Arctic Islands in northern Canada (the "Arctic natural gas assets"). Expenditures relating to capital programs, such as pre-feasibility engineering, technical and support services, research, evaluation drilling and regulatory and stakeholder consultation expenditures are expensed as development expenses. E&E assets are transferred to PP&E once technical feasibility and commercial viability is determined. E&E assets are not available for use and are therefore not amortized.

**Impairment**

The carrying amounts of PP&E and E&E assets are reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. E&E assets are also reviewed for impairment at the time they are transferred to PP&E.

For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows ("cash generating units" or "CGUs"). An impairment loss is recognized for the amount by which the carrying amount of the CGU exceeds its recoverable amount. The recoverable amount is the higher of a CGU's fair value less costs of disposal (being the amount obtainable from the sale of a CGU in an arm's length transaction, net of disposal costs) and its value in use (being the net present value of the CGU's expected future cash flows).

PP&E is combined with the oil sands lease acquisition costs, within the E&E assets, to form one CGU for impairment testing purposes. Any remaining E&E assets form a second CGU, which is tested for impairment separately from the oil sands assets. Impairments are reversed, net of imputed depreciation and depletion, if the reversal can be related objectively to an event occurring after the impairment charge was recognized. Impairment charges and reversals are recorded as depreciation and depletion.

**Revenue Recognition**

Revenue from sales of SCO, including both produced and purchased volumes, and other products is recorded when the significant risks and rewards of ownership transfer to the customer and collection is reasonably assured. Revenue is recorded net of a provision for Crown royalties.

**Employee Future Benefits**
Canadian Oil Sands accrues its proportionate share of Syncrude Canada's post-employment benefit obligations, which include defined benefit and defined contribution pension plans and a defined benefit plan for other post-employment benefits ("OPEB").

The cost of the defined benefit pension and OPEB plans is actuarially determined using the projected unit credit method based on length of service and reflects Canadian Oil Sands' best estimate of financial and demographic variables. The discount rate used to determine the accrued benefit liability is based on a market rate of interest for high-quality corporate debt instruments with cash flows that match the currency and timing of expected benefit payments. Re-measurements of the accrued benefit liability are recognized, net of income taxes, immediately in other comprehensive income and result from actuarial gains and losses and returns on plan assets not included in the accretion of the accrued benefit liability. The current service cost of the defined benefit plans is recognized in operating expenses as the service is rendered. Accretion of the accrued benefit liability is recognized in net finance expense. Any past service costs arising from plan amendments are recognized immediately in operating expenses.

The cost of defined contribution plans is recognized in operating expenses as the service is rendered and contributions become payable.

**Provisions**
Canadian Oil Sands recognizes a provision when it has a legal or constructive present obligation as a result of a past event, it is probable that the obligation will require settlement, and a reliable estimate can be made of the amount of the settlement.

Canadian Oil Sands recognizes a provision for its proportionate share of Syncrude's asset retirement obligation for the reclamation and closure of disturbed mine sites and the decommissioning of utilities plants, bitumen extraction plants and the upgrading complex. The asset retirement obligation is measured at the present value of management's best estimate of the future expenditures required to settle the obligation, discounted using the risk-free interest rate. The asset retirement obligation is recorded on initial land disturbance and is added to the carrying amount of the associated PP&E asset and amortized over the asset's remaining life. The discounted asset retirement obligation is accreted over time through charges to net finance expense with actual expenditures charged against the obligation. Revisions to the estimated timing or amount of future expenditures or changes in the risk-free interest rate are recognized as a change in the asset retirement obligation and related PP&E asset.

Canadian Oil Sands also recognizes a provision for Crown royalties, which is determined pursuant to the Syncrude Royalty Amending Agreement and the Syncrude Bitumen Royalty Option Agreement. The provision for Crown royalties is included in Other liabilities on the Consolidated Balance Sheets with the current portion included in accounts payable and accrued liabilities.

**Taxes**
Deferred tax assets and liabilities are recognized based on the differences between the tax and accounting values of assets and liabilities and/or the timing differences arising when revenues or expenses are included in accounting income in one period and taxable income in a different period. These temporary differences are tax-effected using enacted or substantively enacted tax rates for the periods in which the temporary differences are expected to reverse. The effect of changes to the tax and accounting values or tax rates is recognized in net income, other comprehensive income or shareholders' equity, consistent with the items to which they relate. Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which the assets can be utilized.

Current taxes are estimated on taxable income for the current year at the statutory enacted or substantively enacted tax rates.

**Share-Based Compensation**
Canadian Oil Sands grants share-based awards to officers, select employees and non-executive directors and recognizes the associated share-based compensation expense in administration expenses.

The compensation cost for options granted to officers and select employees is based on the estimated fair values of the options at the time of grant. This cost is recognized in administration expenses over the vesting periods of the options and a corresponding increase to contributed surplus, within shareholders' equity, is recognized at the time of grant. Upon exercise, both the consideration received and the amounts recorded as contributed surplus are recognized as shareholders' capital.

The compensation cost for performance share units ("PSUs") awarded to officers, restricted share units ("RSUs") awarded to select employees and deferred share units ("DSUs") awarded to non-executive directors, is based on the fair values of these awards. This cost is recognized in administration expenses over the vesting periods of the awards with a corresponding liability recognized in accounts payable and accrued liabilities. Changes in the fair values of the PSUs, RSUs, and DSUs during the vesting periods are recognized as administration expenses in the period the change occurs. Upon settlement of these awards by cash, the outstanding liability is reduced. Upon settlement by the issuance of common shares, the outstanding liability is reclassified to shareholders' capital.

As an owner in Syncrude, Canadian Oil Sands recognizes its 36.74 per cent share of Syncrude Canada's share-based compensation awards. The compensation cost for these awards, which are comprised of restricted share units ("Syncrude RSUs") and phantom share units ("Syncrude PSUs") awarded to Syncrude Canada employees, is based on the fair values of these awards. This cost is recognized in operating expenses over the shorter of the normal vesting period and the period to eligible retirement if vesting is accelerated on retirement, with the current portion of the corresponding liability recognized in accounts payable and accrued liabilities and the non-current portion in other liabilities. Changes in the fair values of the Syncrude RSUs and Syncrude PSUs during the vesting periods are recognized as operating expenses in the period the change occurs. Upon settlement of these awards, which is always by cash, the outstanding liability is reduced.

**Foreign Currency Translation**

The principal currency of the economic environment in which the Corporation and its subsidiaries and wholly owned partnership operate is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates in effect at the end of the period, with the resulting gain or loss recognized in net income. Revenues and expenses are translated into Canadian dollars at average exchange rates. Translation gains and losses on U.S. dollar denominated long-term debt are unrealized until the debt obligations are repaid. All other translation gains and losses are classified as realized.

**Net Income Per Share**

Basic net income per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share is calculated by adjusting the weighted-average number of common shares outstanding for dilutive common shares related to the Corporation's share-based compensation plans.

The number of shares included is computed using the treasury stock method, which assumes that proceeds received from the exercise of in-the-money options are used to repurchase common shares at the average market price.

**Dividends**

Dividends on common shares are recognized in the period in which the dividends are approved by the Corporation's Board of Directors.

**Financial Instruments**

All financial instruments are initially measured at fair value. Subsequent measurement of financial instruments is based on their classification as follows:

| Classification | Measurement |
|---|---|
| Fair value through profit or loss | Fair value with changes recognized in net income |
| Held to maturity | Amortized cost using effective interest method |
| Loans and receivables | Amortized cost using effective interest method |
| Available for sale | Fair value with changes recognized in other comprehensive income |
| Other liabilities | Amortized cost using effective interest method |

Transaction costs in respect of financial instruments measured at fair value are recognized immediately in net income. Transaction costs in respect of other financial instruments are included in the initial cost and amortized accordingly using the effective interest method.

The inputs to fair value measurements of financial instruments, including their classification within a hierarchy that prioritizes the inputs to fair value measurement, are as follows:

Level 1: Quoted prices in active markets for identical assets or liabilities;
Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
Level 3: Inputs for the asset or liability that are not based on observable market data.

## 4) Critical Accounting Estimates and Judgments

In order to provide timely financial information to users, the Corporation makes estimates and uses judgment when determining the assets, liabilities, revenues, expenses, commitments and contingencies reported in the consolidated financial statements and notes. The following estimates and judgments are considered critical because actual results could differ materially from reported results if different assumptions underlying these estimates and judgments were used:

***Critical Accounting Estimates***

**a) Asset Retirement Obligation**

In determining the estimated value of the asset retirement obligation, Canadian Oil Sands must estimate the method of reclamation and closure activities, the mine development plans and the timing and amount of associated expenditures. Given the long reserve life of Syncrude's leases and emerging technologies in site reclamation, it is difficult to estimate the precise timing and amount of these expenditures. Any changes in the anticipated method, or in the timing or amount of the expenditures could result in a change to the asset retirement obligation, corresponding PP&E asset, accretion expense (within net finance expense), and depreciation and depletion expense.

**b) Employee Future Benefits**

Canadian Oil Sands accrues its obligations for Syncrude Canada's post-employment benefits using actuarial and other assumptions to estimate the accrued benefit liability and the expense related to the current period. Changes in these assumptions or plan asset returns not included in the accretion of the accrued benefit liability give rise to re-measurement gains and losses. A sensitivity analysis of the impacts of changes in the assumed interest rate used to discount the estimated accrued benefit liability is provided in Note 9.

**c) Impairment**

In determining the recoverable amount of assets subject to impairment testing, Canadian Oil Sands must estimate the reserves and resources it expects to recover and the related future net revenues expected to be generated from producing those reserves and resources. Reserves, resources and future net revenues are evaluated by independent petroleum reserve evaluators who determine these evaluations using various factors and assumptions, such as: forecasts of mining and extraction recovery and upgrading yield based on geological and engineering data, projected future rates of production, projected operating costs, Crown royalties and taxes, projected crude oil prices, oil price differentials and timing and amounts of future capital expenditures and other development costs, all of which are estimates. The factors and assumptions used in the estimates are assessed for reasonableness based on the information available at the time the estimates are prepared. As circumstances change and new information becomes available, the estimates could change. Actual results could vary from estimates, which could cause changes to the asset impairment tests.

**d) Depreciation and Depletion**

Canadian Oil Sands calculates depreciation expense for the majority of its assets on a straight-line basis and must estimate the useful lives of these assets accordingly. While these useful life estimates are reviewed on a regular basis and depreciation calculations are revised accordingly, actual lives may differ from the estimates, resulting in changes to depreciation expense. Canadian Oil Sands calculates depletion expense for asset retirement and mine development costs on a unit-of-production basis and must estimate reserves and resources, which are used as a component of the depletion calculations to allocate capital costs over their estimated useful lives. As circumstances change and new information becomes available, estimated reserves and resources and the resultant depletion calculations could change.

***Critical Accounting Judgments***

**a) Joint Arrangements**

Canadian Oil Sands has applied judgment in determining that Syncrude is under joint control. This determination recognizes that all major growth decisions outside of the original scope of the operations and all product quality changes require unanimous approval of Syncrude's joint interest owners. Because Canadian Oil Sands' investment in Syncrude is primarily held through an undivided interest, it has a proportionate share of the rights to Syncrude's assets and the obligations for Syncrude's liabilities. As a result, Canadian Oil Sands classifies its investment in Syncrude as a *Joint Operation* under IFRS 11, *Joint Arrangements*, and presents its proportionate share of the assets, liabilities, revenues and expenses on a line-by-line basis in the consolidated financial statements. If Canadian Oil Sands did not have both joint control and a proportionate share of the rights to Syncrude's assets and obligations for Syncrude's liabilities, the Corporation would present only its net investment in Syncrude and its proportionate share of Syncrude's net income in the consolidated financial statements.

### b) Asset Retirement Obligation

Canadian Oil Sands applies judgment in determining that the risk-free interest rate is the appropriate rate to discount the asset retirement obligation. Alternatively, a credit-adjusted rate could be used which would yield a smaller asset retirement obligation and corresponding PP&E asset, lower depreciation and depletion expense and a higher accretion expense, which is presented in net finance expense.

### c) Crown Royalties

When calculating the net revenues on which Crown royalties are based, Canadian Oil sands must determine the appropriate deductible costs. This requires the use of judgment in the application of the royalty agreement. It may take several years to establish the appropriate application of the royalty agreement and the final outcome of this could result in amounts different from those initially recorded and could impact Crown royalties in the period in which this is established.

### d) Taxes

In determining its current and deferred tax provisions, Canadian Oil Sands must apply judgment when interpreting and applying complex and changing tax laws and regulations. The determination of the appropriate application of these laws and regulations by tax authorities may remain uncertain for several years. The final outcome of such determination could result in amounts different from those initially recorded and would impact current or deferred tax expense in the period in which a determination is made.

## 5) Inventories

| As at December 31 *($ millions)* | 2014 | 2013 |
|---|---|---|
| Materials and supplies | $ 130 | $ 120 |
| Products | 58 | 43 |
| | $ 188 | $ 163 |

## 6) Property, Plant and Equipment, Net

| | Year ended December 31, 2014 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| *($ millions)* | Upgrading and Extracting | Mining Equipment | Vehicles and Equipment | Buildings | Asset Retirement Costs | Major Turnaround Costs | Construction in Progress | Mine Development | Total |
| **Cost** | | | | | | | | | |
| Opening balance | $ 5,508 | $ 1,941 | $ 695 | $ 345 | $ 851 | $ 174 | $ 1,647 | $ 678 | $ 11,839 |
| Additions | — | — | 23 | — | — | 71 | 836 | — | 930 |
| Change in asset retirement costs | — | — | — | — | 313 | — | — | — | 313 |
| Retirements | (22) | (122) | (26) | — | — | (43) | — | (13) | (226) |
| Reclassifications[1] | 156 | 1,546 | — | 20 | — | — | (1,686) | (36) | — |
| Ending balance | $ 5,642 | $ 3,365 | $ 692 | $ 365 | $ 1,164 | $ 202 | $ 797 | $ 629 | $ 12,856 |
| **Accumulated depreciation** | | | | | | | | | |
| Opening balance | $ 1,626 | $ 601 | $ 349 | $ 115 | $ 223 | $ 86 | $ — | $ 127 | $ 3,127 |
| Depreciation | 192 | 140 | 51 | 9 | 39 | 67 | — | 16 | 514 |
| Retirements | (22) | (122) | (26) | — | — | (43) | — | (13) | (226) |
| Ending balance | $ 1,796 | $ 619 | $ 374 | $ 124 | $ 262 | $ 110 | $ — | $ 130 | $ 3,415 |
| **Net book value at December 31, 2014** | **$ 3,846** | **$ 2,746** | **$ 318** | **$ 241** | **$ 902** | **$ 92** | **$ 797** | **$ 499** | **$ 9,441** |

[1] *Reclassifications are primarily transfers from construction in progress to other categories of property, plant and equipment when construction is completed and assets are available for use.*

| ($ millions) | Upgrading and Extracting | Mining Equipment | Vehicles and Equipment | Buildings | Asset Retirement Costs | Major Turnaround Costs | Construction in Progress | Mine Development | Total |
|---|---|---|---|---|---|---|---|---|---|
| | **Year ended December 31, 2013** | | | | | | | | |
| **Cost** | | | | | | | | | |
| Opening balance | $ 5,300 | $ 1,397 | $ 686 | $ 324 | $ 1,024 | $ 166 | $ 1,501 | $ 392 | $ 10,790 |
| Additions | — | — | 31 | — | — | 54 | 1,257 | — | 1,342 |
| Change in asset retirement costs | — | — | — | — | (190) | — | — | — | (190) |
| Retirements | (25) | (8) | (24) | — | — | (46) | — | — | (103) |
| Reclassifications[1] | 233 | 552 | 2 | 21 | 17 | — | (1,111) | 286 | — |
| Ending balance | $ 5,508 | $ 1,941 | $ 695 | $ 345 | $ 851 | $ 174 | $ 1,647 | $ 678 | $ 11,839 |
| **Accumulated depreciation** | | | | | | | | | |
| Opening balance | $ 1,447 | $ 539 | $ 320 | $ 107 | $ 180 | $ 73 | $ — | $ 121 | $ 2,787 |
| Depreciation | 204 | 70 | 53 | 8 | 43 | 59 | — | 6 | 443 |
| Retirements | (25) | (8) | (24) | — | — | (46) | — | — | (103) |
| Ending balance | $ 1,626 | $ 601 | $ 349 | $ 115 | $ 223 | $ 86 | $ — | $ 127 | $ 3,127 |
| **Net book value at** | | | | | | | | | |
| **December 31, 2013** | **$ 3,882** | **$ 1,340** | **$ 346** | **$ 230** | **$ 628** | **$ 88** | **$ 1,647** | **$ 551** | **$ 8,712** |

[1] *Reclassifications are primarily transfers from construction in progress to other categories of property, plant and equipment when construction is completed and assets are available for use.*

In 2014, interest costs of $111 million were capitalized and included in property, plant and equipment (2013 – $107 million) based on an interest capitalization rate of 6.6 per cent. (2013 - 6.5 per cent)

The Mildred Lake Mine Train Replacement ("MLMR") project was completed by Syncrude in late 2014 resulting in a transfer from Construction in Progress to the appropriate categories of depreciable assets of $1.5 billion, including $162 million of capitalized interest. It is estimated that the additional depreciable assets will increase the annual depreciation and depletion expense by approximately $70 million beginning in 2015.

In early 2015, Canadian Oil Sands performed a review of the estimated useful lives of its mining assets and determined that an increase in the estimated useful life of certain mining assets is required. This will result in an estimated decrease in the annual depreciation and depletion expense of approximately $34 million.

## 7) Accounts Payable and Accrued Liabilities

| As at December 31 *($ millions)* | **2014** | 2013 |
|---|---|---|
| Trade payables | **$ 378** | $ 491 |
| Crown royalties | **132** | 334 |
| Current portion of asset retirement obligation | **18** | 28 |
| Interest payable | **25** | 23 |
| | **$ 553** | $ 876 |
| Less non-current portion of Crown royalties | **(66)** | (90) |
| Accounts payable and accrued liabilities | **$ 487** | $ 786 |

## 8) Income Taxes

The income tax expense recorded on the Consolidated Statements of Income and Comprehensive Income differs from the amount computed by applying the combined Canadian federal and provincial statutory income tax rate to earnings before taxes as follows:

| For the years ended December 31 *($ millions, except income tax rates)* | | 2014 | | 2013 |
|---|---|---|---|---|
| Earnings before taxes | **$** | **631** | $ | 1,113 |
| Statutory income tax rates | | | | |
| Canadian basic federal income tax rate | | **25 %** | | 25 % |
| Canadian federal abatement | | **(10)%** | | (10)% |
| Alberta provincial income tax rate | | **10 %** | | 10 % |
| | | **25 %** | | 25 % |
| Expected taxes at statutory rate | | **158** | | 278 |
| Add (deduct) the tax effect of: | | | | |
| Non-taxable portion of capital losses | | **18** | | 13 |
| Adjustments for prior years and other | | **(5)** | | (12) |
| Tax expense | **$** | **171** | $ | 279 |

Tax expense is comprised of the following:

| For the years ended December 31 *($ millions)* | | 2014 | | 2013 |
|---|---|---|---|---|
| Current tax expense | **$** | **172** | $ | 297 |
| Deferred tax expense | | **(1)** | | (18) |
| | **$** | **171** | $ | 279 |

The amounts shown on the Consolidated Balance Sheets as deferred taxes represent the differences between the accounting and tax values of assets and liabilities and/or the timing differences arising when revenues or expenses are included in accounting income in one period and taxable income in a different period. These temporary differences are tax-effected using enacted or substantively enacted tax rates expected to apply when the temporary differences reverse.

The deferred tax liability on the Consolidated Balance Sheets is comprised of the following:

| As at December 31 *($millions)* | | 2014 | | 2013 |
|---|---|---|---|---|
| Deferred tax assets (liabilities): | | | | |
| Property, plant and equipment in excess of tax value | **$** | **(1,813)** | $ | (1,658) |
| Partnership earnings[1] | | **(98)** | | (162) |
| Liabilities in excess of tax value[2] | | **384** | | 285 |
| Net deferred tax liability[3] | **$** | **(1,527)** | $ | (1,535) |

[1]*The Corporation's taxable income was primarily generated through a partnership and a portion of the related taxes are payable in future periods.*

[2]*Liabilities in excess of tax value mainly consist of the asset retirement obligation and employee future benefits.*

[3]*The deferred tax liability includes $76 million related to temporary differences that are expected to reverse in 2015.*

The following estimated balances are available for deduction against future taxable income:

| As at December 31 *($ millions)* | | 2014 |
|---|---|---|
| Undepreciated Capital Costs[1] | $ | 2,216 |
| Canadian Development Expenses | | 15 |
| Other | | 9 |
| | $ | 2,240 |
| Taxable income generated through a partnership on which taxes are payable in future periods[2] | | (373) |
| Estimated balances available for deduction against future taxable income | $ | 1,867 |

[1] *Approximately 75 per cent of Undepreciated Capital Costs are currently available for deduction at the declining balance rate of 25 per cent annually while the balance relates to multi-year capital projects and were not available for deduction at December 31, 2014.*

[2] *The Corporation's taxable income is primarily generated through a partnership.*

## 9) Employee Future Benefits

Syncrude Canada has defined benefit pension and other post-employment benefit ("OPEB") plans and a defined contribution pension plan covering most of its employees. Benefits under defined benefit pension plans are determined by employees' earnings and tenure. Defined contribution benefits are determined by the amount of contributions, the returns on the invested contributions and employees' tenure. Other post-employment benefits include certain health care and life insurance benefits for retirees, their beneficiaries and covered dependants.

The defined benefit and defined contribution pension plans are subject to government regulations, which govern the administration and certain terms of the plans. The regulations related to the defined benefit pension plan also enforce minimum funding levels and require an actuarial valuation at least every three years, or more frequently if the plans are significantly underfunded. The most recent actuarial valuation of the defined benefit plan was completed in 2014 and was as of December 31, 2013. The next actuarial valuation will be completed during 2015 and will be as of December 31, 2014.

The Syncrude Canada pension committee, comprised of representatives of the Syncrude owners, provides oversight of the employee future benefit plans, including management of the plans' assets.

### a) Defined Benefit Plans

The following table presents the changes in Canadian Oil Sands' share of Syncrude Canada's accrued benefit liability, which is comprised of the accrued benefit obligation, partially offset by the fair value of the plan assets:

| | Pension | | Other Post-Employment Benefits | | Total | |
|---|---|---|---|---|---|---|
| *($ millions)* | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| **Accrued benefit obligation** | | | | | | |
| Balance, beginning of year | **$ 1,012** | $ 997 | **$ 60** | $ 60 | **$ 1,072** | $ 1,057 |
| Current service cost | **41** | 44 | **1** | 1 | **42** | 45 |
| Estimated interest expense[1] | **46** | 40 | **3** | 2 | **49** | 42 |
| Re-measurements: | | | | | | |
| (Gain) loss from change in demographic assumptions[2] | **(1)** | 52 | **(1)** | 3 | **(2)** | 55 |
| (Gain) loss from change in financial assumptions[3] | **97** | (87) | **3** | (4) | **100** | (91) |
| Employee contributions | **3** | 6 | **—** | — | **3** | 6 |
| Benefits paid | **(40)** | (40) | **(2)** | (2) | **(42)** | (42) |
| Balance, end of year | **$ 1,158** | $ 1,012 | **$ 64** | $ 60 | **$ 1,222** | $ 1,072 |
| **Fair value of plan assets** | | | | | | |
| Balance, beginning of year | **$ 764** | $ 619 | **$ —** | $ — | **$ 764** | $ 619 |
| Estimated interest income[1] | **35** | 26 | **—** | — | **35** | 26 |
| Re-measurements: | | | | | | |
| Return on plan assets[4] | **76** | 46 | **—** | — | **76** | 46 |
| Employer contributions | **42** | 106 | **—** | — | **42** | 106 |
| Employee contributions | **3** | 6 | **—** | — | **3** | 6 |
| Benefits paid | **(36)** | (39) | **—** | — | **(36)** | (39) |
| Balance, end of year | **$ 884** | $ 764 | **$ —** | $ — | **$ 884** | $ 764 |
| **Accrued benefit liability** | **$ (274)** | $ (248) | **$ (64)** | $ (60) | **$ (338)** | $ (308) |
| **Current portion** | **$ (17)** | $ (80) | **$ (3)** | $ (2) | **$ (20)** | $ (82) |
| **Non-current portion** | **$ (257)** | $ (168) | **$ (61)** | $ (58) | **$ (318)** | $ (226) |

[1] *Estimated interest expense and estimated interest income are presented within net finance expense in the consolidated statements of income and comprehensive income.*

[2] *Demographic assumptions include: average life expectancy; rates of turnover, disability and early retirement; number of dependents eligible for benefits; and claim rates (OPEB plan). The re-measurement loss in 2013 reflects the impact of an increase in the estimated average lifespan of the plans' beneficiaries as a result of new actuarial standards.*

[3] *Financial assumptions include: discount rate; future salaries and benefit levels; future medical costs (OPEB plan); and taxes payable by the plans.*

[4] *Difference between actual return on plan assets and estimated interest income.*

The weighted average duration of the accrued benefit obligation is 22 years for the pension plan and 15 years for the other post-employment benefit plans.

The costs of the defined benefit plans have been recorded in the Consolidated Statements of Income and Comprehensive Income as follows:

| | Pension | | Other Post-Employment Benefits | | Total | |
|---|---|---|---|---|---|---|
| As at December 31 *($ millions)* | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| Operating expenses[1] | **$ 41** | $ 44 | **$ 1** | $ 1 | **$ 42** | $ 45 |
| Net finance expense[2] | **11** | 14 | **3** | 2 | **14** | 16 |
| **Recognized in net income** | **$ 52** | $ 58 | **$ 4** | $ 3 | **$ 56** | $ 61 |
| Re-measurements | **$ 20** | $ (81) | **$ 2** | $ (1) | **$ 22** | $ (82) |
| Tax on re-measurements | **(5)** | 21 | **—** | — | **(5)** | 21 |
| **Recognized in other comprehensive income** | **$ 15** | $ (60) | **$ 2** | $ (1) | **$ 17** | $ (61) |

[1]*Current service cost.*
[2]*Includes estimated interest cost on the accrued benefit obligation, partially offset by estimated interest income on the plan assets.*

The accrued benefit obligation relates to both unfunded and partly funded plans as follows:

| | Pension | | Other Post-Employment Benefits | | Total | |
|---|---|---|---|---|---|---|
| As at December 31 *($ millions)* | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| Accrued benefit obligation arising from: | | | | | | |
| Unfunded plans | **$ 56** | $ 52 | **$ 64** | $ 60 | **$ 120** | $ 112 |
| Partly funded plans | **1,102** | 960 | **—** | — | **1,102** | 960 |
| | **$ 1,158** | $ 1,012 | **$ 64** | $ 60 | **$ 1,222** | $ 1,072 |

The asset allocation for Syncrude Canada's defined benefit plan assets was as follows:

| | Percentage of Plan assets | |
|---|---|---|
| As at December 31 | **2014** | 2013 |
| Equity securities[1] | **59** | 60 |
| Debt securities[2] | **41** | 40 |
| | **100** | 100 |

[1]*Comprised of global and Canadian securities.*
[2]*Comprised mainly of a long-term bond fund.*

Syncrude Canada's plan assets are invested using a passive strategy with investments in indexed securities. Investments that are not traded in active markets are not significant.

***Significant Assumptions and Risks***
Inherent in a defined benefit plan for employee future benefits are several risks associated with meeting the defined benefit obligation as it becomes due. The most significant risks are asset volatility and changes in interest rates, inflation and life expectancy. Each of these risks can have a material impact on the accrued benefit liability in any given year. The risk of asset volatility is mitigated through investment strategies.

The significant assumptions used to measure the defined benefit plans are as follows:

| As at December 31 | Pension | | Other Post-Employment Benefits | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Discount rate applied to accrued benefit liability | **4.00%** | 4.50% | **4.00%** | 4.50% |
| Rate of compensation increase | **2.92%** | 3.17% | **2.92%** | 3.17% |
| Rate of supplemental health care cost increases[1] | **n/a** | n/a | **7.00%** | 7.00% |
| Rate of dental cost increases | **n/a** | n/a | **4.00%** | 4.00% |
| Average life expectancy in years: | | | | |
| Male | **87** | **87** | **87** | **87** |
| Female | **90** | **89** | **90** | **89** |

[1] *Seven per cent annual rate of increase assumed for 2013 through 2016 decreasing by 0.5 per cent each year thereafter to a five per cent ultimate rate in 2020.*

***Sensitivity Analysis***

A one per cent decrease in the interest rate used to discount future benefit payments would result in a $232 million increase in Canadian Oil Sands' accrued benefit liability, a $14 million increase in 2014 current service costs and a $3 million decrease in the 2014 interest expense. A one per cent increase in the interest rate would result in a $178 million decrease in Canadian Oil Sands' accrued benefit liability, a $10 million decrease in 2014 current service costs and a $2 million increase in the 2014 interest expense.

A one per cent increase in the assumed salary scale would result in a $52 million increase in Canadian Oil Sands' accrued benefit liability, a $5 million increase in 2014 current service costs and a $2 million increase in the 2014 interest expense. A one per cent decrease in the salary scale would result in a $45 million decrease in Canadian Oil Sands' accrued benefit liability, a $4 million decrease in 2014 current service costs and a $2 million decrease in the 2014 interest expense

A one per cent increase in assumed health care and dental cost trend rates would increase Canadian Oil Sands' accrued benefit liability by $5 million, and a one per cent decrease would decrease the accrued benefit liability by $5 million. A one per cent increase or decrease in the health care cost trend rates would have an insignificant impact on Canadian Oil Sands' current service costs and interest expense.

Increasing the average lifespan for members by one year would increase the accrued benefit liability by $26 million.

**b) Defined Contribution Plans**

Canadian Oil Sands' share of Syncrude Canada's defined contribution pension plan expense was approximately $3 million in 2014 (2013 - $3 million).

**c) Cash Payments**

Canadian Oil Sands' share of Syncrude's total cash payments for employee future benefits for 2014 was $51 million (2013 - $112 million), consisting of cash contributed by Syncrude Canada to its defined benefit pension and OPEB plans and to its defined contribution pension plan, including contributions to fund benefit payments in excess of registered plan limits.

Canadian Oil Sands' share of Syncrude Canada's estimated 2015 cash payments to fund the defined benefit plans is $43 million, including $15 million for Canadian Oil Sands' share of solvency funding requirements. The actuarial valuation completed in 2014 requires Syncrude Canada to fund a pension plan solvency deficiency, Canadian Oil Sands' share of which is $68 million due over the next 11 years.

## 10) Long-term Debt and Credit Facilities

### Outstanding long-term debt

| As at December 31 *($millions)* | | 2014 | | 2013 |
|---|---|---|---|---|
| 7.75% Senior Notes due May 15, 2019 (U.S. $500 million) (a) | **$** | **577** | $ | 529 |
| 7.9% Senior Notes due September 1, 2021 (U.S. $250 million) (b) | | **287** | | 262 |
| 4.5% Senior Notes due April 1, 2022 (U.S. $400 million) (c) | | **458** | | 420 |
| 8.2% Senior Notes due April 1, 2027 (U.S. $73.95 million) (d) | | **84** | | 77 |
| 6.0% Senior Notes due April 1, 2042 (U.S. $300 million) (e) | | **343** | | 314 |
| Credit facilities drawn, excluding letters of credit | | **140** | | — |
| | **$** | **1,889** | $ | 1,602 |

Canadian Oil Sands' Senior Notes are unsecured, rank pari passu with other senior unsecured debt of the Corporation, and contain certain covenants that place limitations on the sale of assets and the granting of liens or other security interests.

**a) 7.75% Senior Notes**
On May 11, 2009, the Corporation issued U.S. $500 million of 7.75% Senior Notes, maturing May 15, 2019. Interest is payable on the notes semi-annually on May 15 and November 15.

**b) 7.9% Senior Notes**
On August 24, 2001, the Corporation issued U.S. $250 million of 7.9% Senior Notes, maturing September 1, 2021. Interest is payable on the notes semi-annually on March 1 and September 1. The Corporation has agreed to maintain its long-term debt-to-total capitalization at an amount less than 55 per cent.

**c) 4.5% Senior Notes**
On March 29, 2012, the Corporation issued U.S. $400 million of 4.5% Senior Notes, maturing April 1, 2022. Interest is payable on the notes semi-annually on April 1 and October 1.

**d) 8.2% Senior Notes**
On April 1, 1997, the Corporation issued U.S. $75 million of 8.2% Senior Notes, maturing April 1, 2027, and retired U.S. $1.05 million during 2000. Interest is payable on the notes semi-annually on April 1 and October 1.

**e) 6.0% Senior Notes**
On March 29, 2012, the Corporation issued U.S. $300 million of 6.0% Senior Notes, maturing April 1, 2042. Interest is payable on the notes semi-annually on April 1 and October 1.

### Future Payments

Canadian Oil Sands is required to make the following principal and interest payments on Senior Notes:

| | | |
|---|---|---|
| 2015 | $ | 117 |
| 2016-2017 | | 233 |
| 2018-2019 | | 785 |
| After 2019 | | 1,789 |
| | $ | 2,924 |

### Credit facilities

Canadian Oil Sands' credit facilities had the following aggregate limits:

| As at December 31 *($ millions)* | | 2014 |
|---|---|---|
| Operating credit facility (a) | $ | 1,500 |
| Extendible revolving term facility (b) | | 40 |
| Line of credit (c) | | 175 |
| | **$** | **1,715** |

Canadian Oil Sands' credit facilities are unsecured. The credit facility agreements contain covenants restricting Canadian Oil Sands' ability to sell all or substantially all of its assets or to change the nature of its business. The credit facility agreements also require Canadian Oil Sands to maintain its total debt-to-total capitalization at an amount less than 60 per cent, or 65 per cent in certain circumstances involving acquisitions.

**a) Operating Credit Facility**

The $1,500 million credit facility expires on June 30, 2018. Amounts borrowed through this facility bear interest at a floating rate based on either prime interest rates or bankers' acceptances plus a credit spread. Any unused amounts are subject to standby fees. As at December 31, 2014, $140 million was drawn against this facility ($nil at December 31, 2013).

**b) Extendible Revolving Term Facility**

The $40 million extendible revolving term facility is a two year facility expiring June 30, 2016. This facility may be extended on an annual basis with the agreement of the bank. Amounts borrowed through this facility bear interest at a floating rate based on bankers' acceptances plus a credit spread. Any unused amounts are subject to standby fees. At December 31, 2014, no amounts were drawn against this facility (no amounts were drawn against the facility at December 31, 2013).

**c) Line of Credit**

The $175 million line of credit is made up of one-year revolving letter of credit facilities. Letters of credit drawn on these facilities mature June 30th each year and are automatically renewed, unless notification to cancel is provided at least 60 days prior to expiry by either Canadian Oil Sands or the financial institution providing the facility. Letters of credit written on the facilities bear interest at a credit spread. Letters of credit of approximately $75 million have been written against the line of credit as at December 31, 2014 (December 31, 2013 - $75 million).

## 11) Asset Retirement Obligation and Reclamation Trust

Canadian Oil Sands and each of the other Syncrude owners are liable for their share of ongoing obligations related to the reclamation and closure of the Syncrude properties on abandonment. The Corporation estimates reclamation and closure expenditures on disturbed mines and existing facilities will be made over approximately the next 70 years and has applied a risk-free interest rate of 2.25 per cent at December 31, 2014 (December 31, 2013 – 3.25 per cent) in deriving the asset retirement obligation.

| *($ millions)* | **December 31 2014** | December 31 2013 |
|---|---|---|
| Asset retirement obligation, beginning of year | **$ 896** | $ 1,102 |
| (Increase) decrease in risk-free interest rate | **224** | (217) |
| Reclamation expenditures | **(18)** | (42) |
| Increase in estimated reclamation and closure expenditures | **89** | 27 |
| Accretion expense | **28** | 26 |
| Asset retirement obligation, end of year | **$ 1,219** | $ 896 |
| Less current portion | **(18)** | (28) |
| Non-current portion | **$ 1,201** | $ 868 |

The changes in the asset retirement obligation due to increases and decreases in the risk-free interest rate and increases in estimated reclamation and closure expenditures were recorded as changes in property, plant and equipment. The $18 million current portion of the asset retirement obligation is included in accounts payable and accrued liabilities, while the $1,201 million non-current portion is presented separately as an asset retirement obligation on the December 31, 2014 Consolidated Balance Sheet. The total undiscounted estimated cash flows required to settle Canadian Oil Sands' share of the asset retirement obligation were $2,375 million at December 31, 2014 (December 31, 2013 - $2,160 million).

A review of the estimated reclamation and closure expenditures is performed annually. In 2014, the review resulted in an $89 million increase to the asset retirement obligation, reflecting the planned extension of a mine site and higher estimated costs for material movement.

The reclamation and closure expenditures will be funded from Canadian Oil Sands' cash flow from operations and a reclamation trust. In addition to annual funding for reclamation expenditures, Canadian Oil Sands deposits $0.25 per barrel of production attributable to its working interest in Syncrude to a reclamation trust established for the purpose of funding its share of reclamation and closure obligations. As at December 31, 2014, the balance of the reclamation trust, including interest earned on investments, was $87 million (December 31, 2013 - $78 million).

Additionally, Canadian Oil Sands has posted letters of credit with the Province of Alberta in the amount of $75 million (December 31, 2013 - $75 million) to secure its pro rata share of the reclamation and closure obligations of the Syncrude owners.

## 12) Other Liabilities

| *As at ($ millions)* | December 31 2014 | December 31 2013 |
|---|---|---|
| Non-current portion of Crown royalties[1] | **$ 66** | $ 90 |
| Other | **9** | 10 |
| Other liabilities | **$ 75** | $ 100 |

[1] *Transition royalties due under Syncrude's Royalty Amending Agreement and payable in January 2016.*

## 13) Shareholders' Equity

### a) Shareholders' Capital

The Corporation is authorized to issue an unlimited number of Common Shares without nominal or par value, and a maximum of 10,000,000 preferred shares, issuable in series.

| | Number of Shares *(millions)* | Proceeds *($ millions)* |
|---|---|---|
| Shareholders' capital, January 1, 2013 | 484.56 | $ 2,673 |
| Issued under share-based compensation plans | 0.01 | 1 |
| Shareholders' capital, December 31, 2013 | 484.57 | 2,674 |
| Issued under share-based compensation plans | 0.04 | 1 |
| Shareholders' capital, December 31, 2014 | 484.61 | 2,675 |

### b) Net Income Per Share

The following table summarizes the Shares used in calculating net income per Share:

| For the years ended December 31 *(millions)* | 2014 | 2013 |
|---|---|---|
| Weighted-average Shares outstanding, Basic | **485** | 485 |
| Effect of options | **—** | — |
| Weighted-average Shares outstanding, Diluted | **485** | 485 |

### c) Dividends

During the year, the Corporation paid dividends of $678 million (2013 - $678 million) or $1.40 per Share (2013 - $1.40 per Share). On January 29, 2015, the Corporation declared a quarterly dividend of $0.05 per Share for a total dividend of $24 million. The dividend will be paid on February 27, 2015 to Shareholders of record on February 20, 2015.

## 14) Share-based Compensation

Canadian Oil Sands issues options, PSUs and RSUs under its long-term incentive plans for employees and DSUs as a component of non-executive directors' compensation. In addition, Syncrude Canada issues Syncrude RSUs and Syncrude PSUs for which Canadian Oil Sands records its 36.74 per cent ownership share.

The following table indicates the number of units outstanding and the amounts Canadian Oil Sands recorded in its consolidated financial statements related to share-based compensation awards in 2014 and 2013:

| *($ millions, except unit amounts)* | Options (a) | PSUs (b) | RSUs (c) | DSUs (d) | Syncrude RSUs (e) | Syncrude PSUs *(f)* | Total |
|---|---|---|---|---|---|---|---|
| **2014** | | | | | | | |
| **Units outstanding at December 31** | **3,852,403** | **314,094** | **36,996** | **137,138** | **968,426** | **1,599,704** | |
| **Expense recognized during the year** | **$ 2** | **$ (1)** | **$ —** | **$ —** | **$ 4** | **$ (4)** | **$ 1** |
| **Liability recognized at December 31** | **n/a** | **$ 1** | **$ —** | **$ 1** | **$ 10** | **$ 1** | **$ 13** |
| 2013 | | | | | | | |
| Units outstanding at December 31 | 2,975,896 | 282,638 | 30,640 | 91,194 | 796,777 | 1,833,768 | |
| Expense recognized during the year | $ 3 | $ 2 | $ — | $ 1 | $ 8 | $ — | $ 14 |
| Liability recognized at December 31 | n/a | $ 4 | $ — | $ 2 | $ 11 | $ 6 | $ 23 |

Details of the share-based compensation awards are as follows:

| *(Units)* | **Options (a)** | **PSUs (b)** | **RSUs (c)** | **DSUs (d)** | **Syncrude RSUs (e)** | **Syncrude PSUs (f)** |
|---|---|---|---|---|---|---|
| **Outstanding at January 1, 2014** | **2,975,896** | **282,638** | **30,640** | **91,194** | **796,777** | **1,833,768** |
| **Granted during 2014** | **1,098,536** | **105,785** | **18,896** | **45,944** | **381,859** | **—** |
| **Redeemed during 2014** | **(33,458)** | **(74,329)** | **(7,560)** | **—** | **(180,271)** | **(233,116)** |
| **Forfeited during 2014** | **(188,571)** | **—** | **(4,980)** | **—** | **(29,939)** | **(948)** |
| **Outstanding at December 31, 2014[1]** | **3,852,403** | **314,094** | **36,996** | **137,138** | **968,426** | **1,599,704** |
| **Less unvested at December 31, 2014** | **(1,874,358)** | **(314,094)** | **(36,996)** | **—** | **(968,426)** | **(192,367)** |
| **Vested at December 31, 2014** | **1,978,045** | **—** | **—** | **137,138** | **—** | **1,407,337** |
| **Unvested awards scheduled to vest during:** | | | | | | |
| **2015** | **824,164** | **89,476** | **9,944** | **—** | **279,105** | **192,367** |
| **2016** | **684,010** | **118,833** | **11,750** | **—** | **345,759** | **—** |
| **2017** | **366,184** | **105,785** | **15,302** | **—** | **343,562** | **—** |
| | **1,874,358** | **314,094** | **36,996** | **—** | **968,426** | **192,367** |

[1] *The weighted-average exercise price of options outstanding at December 31, 2014 was $23.44 and the weighted-average remaining life of options outstanding at December 31, 2014 was 4 years.*

### a) Options

Canadian Oil Sands' options provide the holder with a right to purchase a Share at the exercise price determined at the grant date. For options granted prior to 2011, exercise prices are reduced by dividends over a threshold amount. Subject to certain exceptions relating to retirement, death or termination, the options vest by one-third following the date of grant in each of the first three years and expire seven years after the date of grant.

The weighted-average exercise price and significant assumptions for options granted during 2014 were as follows:

| | **2014** |
|---|---|
| Weighted-average exercise price ($) | **20.01** |
| Assumed interest rate (%) | **1.55** |
| Assumed life (years) | **5** |
| Assumed volatility (%) | **27** |
| Assumed dividend yield (%) | **7.00** |
| Weighted-average grant-date fair value ($/option) | **2.02** |

### b) PSUs

Canadian Oil Sands' PSUs are awarded and settled in cash, in Shares purchased in the secondary market, or in Shares issued from treasury, at the end of a three-year vesting period. The settlement value is based on the Corporation's Share price at the end of the vesting period, dividends paid by the Corporation during the vesting period and the total Shareholder return generated by the Corporation relative to a comparator group, comprised of other industry peers, over the vesting period.

### c) RSUs

Canadian Oil Sands' RSUs are awarded and settled in cash, in Shares purchased in the secondary market, or in Shares issued from treasury, at the end of a three-year vesting period. The settlement value is based on the Corporation's Share price at the end of the vesting period and dividends paid by the Corporation during the vesting period.

### d) DSUs

Canadian Oil Sands' DSUs are awarded and settled in cash, in Shares purchased in the secondary market or in Shares issued from treasury. DSUs vest immediately upon grant and settle when a director's service ceases. The settlement value is based on the Corporation's Share price at settlement and dividends paid by the Corporation while the DSUs are outstanding.

### e) Syncrude RSUs

Syncrude Canada awards Syncrude RSUs to certain employees. Subject to certain exceptions relating to retirement, death or termination, Syncrude RSUs are settled in cash at the end of a three-year vesting period. There are two types of Syncrude RSUs. The cash settlement for the first type is based on the weighted-average price of certain Syncrude owners' shares and the total shareholder return of such owners' shares over the vesting period relative to a peer group. The cash settlement for the second type is based purely on the weighted-average price of certain Syncrude owners' shares, and is not contingent on shareholder return.

### f) Syncrude PSUs

Syncrude Canada awards Syncrude PSUs to certain employees. Subject to certain exceptions relating to retirement, death or termination, Syncrude PSUs have a term of seven years and vest in equal amounts over a three-year period. Syncrude PSUs are settled in cash at a value based on the amount by which the weighted-average price of certain Syncrude owners' shares on the settlement date exceeds the weighted-average price on the grant date.

## 15) Foreign Exchange

| For the years ended December 31 *($ millions)* | **2014** | 2013 |
|---|---|---|
| Foreign exchange loss – long-term debt | **$ 145** | $ 115 |
| Foreign exchange gain – other | **(11)** | (27) |
| Total foreign exchange loss | **$ 134** | $ 88 |

## 16) Net Finance Expense

| For the years ended December 31 *($ millions)* | **2014** | 2013 |
|---|---|---|
| Interest costs on long-term debt | **$ 119** | $ 123 |
| Less capitalized interest on long-term debt | **(111)** | (107) |
| Interest expense on long-term debt | **$ 8** | $ 16 |
| Interest expense on employee future benefits | **14** | 16 |
| Accretion of asset retirement obligation | **28** | 26 |
| Interest income | **(3)** | (14) |
| Net finance expense | **47** | 44 |

## 17) Capital Management

The Corporation's capital consists of cash and cash equivalents, debt and Shareholders' equity. The balance of each of these items at December 31, 2014 and December 31, 2013 was as follows:

| As at *($ millions, except % amounts)* | December 31 2014 | December 31 2013 |
|---|---|---|
| Long-term debt[1] | **$ 1,889** | $ 1,602 |
| Cash and cash equivalents[1] | **(33)** | (806) |
| Net debt[2,3] | **$ 1,856** | $ 796 |
| Shareholders' equity[1] | **$ 4,497** | $ 4,732 |
| Total net capitalization[2,4] | **$ 6,353** | $ 5,528 |
| Total capitalization[2,5] | **$ 6,386** | $ 6,334 |
| Net debt-to-total net capitalization[2,6] (%) | **29** | 14 |
| Long-term debt-to-total capitalization[2,7] (%) | **30** | 25 |

*[1] As reported in the Consolidated Balance Sheets.*
*[2] Additional GAAP financial measure.*
*[3] Long-term debt less cash and cash equivalents.*
*[4] Net debt plus Shareholders' equity.*
*[5] Long-term debt plus Shareholders' equity.*
*[6] Net debt divided by total net capitalization.*
*[7] Long-term debt divided by total capitalization.*

The Corporation's objectives for managing capital are to:

- ensure financing capacity for Syncrude's investing activities;
- target an investment grade credit rating with financial flexibility to control risk and allow the Corporation to maintain its crude oil price exposure; and
- distribute to Shareholders any cash that is not required for financing Syncrude's operations or capital investment.

Net debt rose to $1,856 million in 2014 from $796 million in 2013 concurrent with higher spending on major capital projects over the last two years. In addition, a weakening Canadian dollar over the same period increased the Canadian dollar equivalent value of long-term debt. As a result, net debt-to-total net capitalization increased to 29 per cent at December 31, 2014 from 14 per cent at December 31, 2013.

In August 2013, Canadian Oil Sands repaid U.S. $300 million of Senior Notes upon maturity.

In July 2014, Canadian Oil Sands extended the terms of its credit facilities. The $1.5 billion credit facility was extended to June 30, 2018 and the $40 million credit facility to June 30, 2016. As at December 31, 2014, $140 million was drawn against these facilities (December 31, 2013 and December 31, 2012 - $nil).

Shareholders' equity decreased to $4,497 million at December 31, 2014 from $4,732 million at December 31, 2013, as dividends exceeded comprehensive income during the year.

The Corporation reduced its quarterly dividend to $0.05 per Share for the first quarter of 2015 from $0.35 per Share to better align with current oil prices and to preserve balance sheet strength in the short and medium term.

Canadian Oil Sands Senior Notes indentures and credit facility agreements contain certain covenants that restrict Canadian Oil Sands' ability to sell all or substantially all of its assets or change the nature of its business, and limit long-term debt-to-total capitalization to 55 per cent. With a long-term debt-to-total capitalization of 30 per cent at December 31, 2014, a significant increase in debt or decrease in equity would be required to negatively impact the Corporation's financial flexibility.

## 18) Financial Instruments

The Corporation's financial instruments include cash and cash equivalents, accounts receivable, investments held in a reclamation trust, accounts payable and accrued liabilities, and long-term debt. The carrying values of the Corporation's financial instruments and their related categories at December 31, 2014 and 2013 were as follows:

| As at December 31 *($ millions)* | | 2014 | | 2013 |
|---|---|---|---|---|
| **Financial Assets** | | | | |
| Loans and receivables | | | | |
| Cash and cash equivalents | **$** | **33** | $ | 806 |
| Accounts receivable | | **185** | | 369 |
| Reclamation trust | | **87** | | 78 |
| | **$** | **305** | $ | 1,253 |
| **Financial Liabilities** | | | | |
| Other liabilities | | | | |
| Accounts payable and accrued liabilities[1] | **$** | **474** | $ | 760 |
| Long-term debt | | **1,889** | | 1,602 |
| | **$** | **2,363** | $ | 2,362 |

[1] *Excludes current portion of asset retirement obligation and other non-financial instruments.*

**Offsetting Financial Assets and Financial Liabilities**
The carrying values of accounts receivable and accounts payable and accrued liabilities have each been reduced by $52 million ($49 million at December 31, 2013) as a result of netting agreements with counterparties.

**Fair Values**
The fair values of cash and cash equivalents, accounts receivable, reclamation trust investments, accounts payable and accrued liabilities, and amounts drawn on the credit facility recorded as long-term debt approximate their carrying values due to the short-term nature of those instruments. The following fair values of long-term debt are based on Level 2 inputs to fair value measurement, which represent indicative bids or spreads for a round lot transaction within the relevant market:

| As at December 31 *($ millions)* | | 2014 | | 2013 |
|---|---|---|---|---|
| 7.75% Senior Notes due May 15, 2019 (U.S. $500 million) | **$** | **626** | $ | 636 |
| 7.9% Senior Notes due September 1, 2021 (U.S. $250 million) | | **314** | | 321 |
| 4.5% Senior Notes due April 1, 2022 (U.S. $400 million) | | **433** | | 425 |
| 8.2% Senior Notes due April 1, 2027 (U.S. $73.95 million) | | **96** | | 95 |
| 6.0% Senior Notes due April 1, 2042 (U.S. $300 million) | | **313** | | 323 |
| | **$** | **1,782** | $ | 1,800 |

**Financial Risks**

**a) Foreign Currency Risk**
Canadian Oil Sands' results are affected by fluctuations in the U.S./Canadian currency exchange rates as our sales are based in part on a WTI benchmark price in U.S. dollars, while operating expenses and capital expenditures are primarily in Canadian dollars. During 2014 and 2013, the U.S. to Canadian dollar exchange rate has ranged from a low of $0.86 U.S./Cdn to a high of $1.02 U.S./Cdn. Our sales exposure is partially offset by our U.S. dollar crude oil purchases, our share of Syncrude's U.S. dollar operating and capital costs, interest costs on U.S. dollar denominated long-term debt and, in periods when our U.S. dollar denominated long-term debt matures, the principal repayments.

Canadian Oil Sands prefers to remain unhedged on foreign currency and did not have any foreign currency hedges in place in 2014 or 2013; however, the Corporation may hedge foreign currency rates in the future depending on the business environment and growth opportunities.

As at December 31, 2014, portions of Canadian Oil Sands' cash and cash equivalents, accounts receivable, accounts payable and long-term debt were denominated in U.S. dollars. Based on these U.S. dollar closing balances, 2014 net income and comprehensive income would have increased/decreased by approximately $20 million (2013 - $15 million) for every $0.01 decrease/increase in the value of the U.S./Cdn currency exchange rate.

**b) Interest Rate Risk**
Canadian Oil Sands is exposed to interest rate risk as changes in market interest rates may affect the Corporation's financial results and financial condition.

The principal exposure relates to the Corporation's long-term debt, in particular the refinancing of our fixed rate long-term debt on maturity or, to the extent there are amounts drawn, our variable-rate credit facilities. The next Senior Note maturity is in 2019 and, at December 31, 2014, $140 million was drawn on the credit facilities. The interest rate the Corporation pays on its long-term debt is also impacted by its credit ratings.

Changes in interest rates also impact the Corporation's short-term investments, which are continually reinvested with maturities of less than 90 days, our obligation for employee future benefits and our asset retirement obligation. Changes in interest rates impact the carrying value of the accrued benefit liability as well as the ongoing interest costs, current service costs and cash funding of our employee future benefits. Interest rates also impact the carrying value of the asset retirement obligation and the related accretion and depreciation and depletion expenses.

Additional information about interest rate sensitivity for the Corporation's employee future benefits is provided in the "Critical Accounting Estimates and Judgments" section of this MD&A.

**c) Credit Risk**
Canadian Oil Sands is exposed to credit risk primarily through customer accounts receivable balances, financial counterparties with whom the Corporation has invested its cash and cash equivalents and with its insurance providers in the event of an outstanding claim.

The maximum exposure to any one customer or financial counterparty is managed through a credit policy that limits exposure based on credit ratings. The policy also specifically limits the aggregate exposure to customers with a credit rating below investment grade to a maximum of 25 per cent of Canadian Oil Sands' consolidated accounts receivable. This credit risk concentration is monitored on a regular basis. Risk is further mitigated as accounts receivable with customers typically are settled in the month following the sale, and investments with financial counterparties are typically short-term in nature and are placed with institutions that have a credit rating of "R-1 (low)" or better, as defined by the Dominion Bond Rating Service ("DBRS").

Canadian Oil Sands carries credit insurance on some counterparties to help mitigate a portion of the impact should a loss occur and continues to transact primarily with investment-grade customers. The Corporation's maximum credit exposure related to customer receivables was $185 million at December 31, 2014, all of which were paid in January 2015. Substantially all accounts receivable are due from investment grade energy producers, financial institutions, and refinery-based customers, and our cash and cash equivalents are invested in deposits and bankers' acceptances with high-quality senior banks as well as investment grade commercial paper. At present, there are no financial assets that are past their maturity or impaired due to credit risk-related defaults.

**d) Liquidity Risk**
Liquidity risk is the risk that Canadian Oil Sands will not be able to meet its financial obligations as they become due and is impacted by: the amount and timing of operating commitments, future capital expenditure requirements and debt repayments as well as the adequacy of financing available through bank credit facilities or debt and equity capital markets. In addition, a downgrade in the Corporation's credit ratings may impact the cost of and our ability to access financing, and may require the Corporation to provide financial security under certain transportation and storage contracts.

The ability to make scheduled payments on or to refinance debt obligations depends on the financial condition and operating performance of the Corporation, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond its control. Volatility in the credit markets may increase costs associated with debt instruments due to increased spreads over relevant interest rate benchmarks, or affect the Corporation's, or third parties that the Corporation seeks to do business with, ability to access those markets. The Corporation may be unable to maintain a level of cash flow from operations sufficient to permit it to pay the principal, premium, if any, and interest on its indebtedness. In addition, there may be volatility in the capital markets and access to financing, although currently available, can be uncertain. These conditions could have an adverse effect on the industry in which the Corporation operates and its business, including future operating and financial results.

Canadian Oil Sands actively manages its liquidity through cash, debt and equity management strategies. Such strategies encompass, among other factors: having adequate sources of financing available through bank credit facilities, estimating future cash flow from operations based on reasonable production and pricing assumptions, understanding operating commitments and future capital expenditure requirements and complying with debt covenants. In addition, over the long-term, Canadian Oil Sands spreads out the maturities of its various debt tranches, maintains a prudent capital structure and is in compliance with its debt covenants.

## 19) Key Management Personnel Compensation

Key management personnel include the Corporation's Board of Directors and certain members of senior management. Canadian Oil Sands recorded the following amounts in its financial statements relating to key management personnel compensation in 2014 and 2013:

| *($ millions)* | | **2014** | | 2013 |
|---|---|---|---|---|
| Expense for the year | | | | |
| Short-term benefits expense[1] | **$** | **4** | $ | 7 |
| Share-based compensation expense | | **2** | | 5 |
| | **$** | **6** | $ | 12 |
| Liability recorded at December 31[2] | **$** | **3** | $ | 6 |

[1]*Short-term benefits include salaries, annual incentive plan payments, the Corporation's contributions to savings accounts on behalf of key management personnel and fees paid to directors.*

[2]*Liability owing to key management personnel for short-term benefits and share-based compensation.*

## 20) Commitments

Canadian Oil Sands is obligated to make future cash payments under contractual agreements that it has entered into either directly or as a 36.74 per cent owner in Syncrude. Cash from operating activities and credit facilities, if required, are expected to be sufficient to fund the contractual obligations and commitments as they become due. The following table outlines the significant commitments that the Corporation will be required to fund which are not recorded as liabilities:

| | Cash Outflow By Period | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| *($ millions)* | | Total | | 2015 | | 2016 to 2017 | | 2018 to 2019 | After 2019 |
| Pipeline and storage (a) | $ | 2,294 | $ | 67 | $ | 129 | $ | 173 | $ 1,925 |
| Other (b) | | 322 | | 163 | | 87 | | 25 | 47 |
| | $ | 2,616 | $ | 230 | $ | 216 | $ | 198 | $ 1,972 |

### a) Pipeline and Storage

Canadian Oil Sands transports crude oil to customers and incurs transportation and storage costs as a result. To secure access to preferred markets and enhance marketing flexibility, the Corporation has take-or-pay commitments for the transportation and storage of crude oil. Commitments for crude oil transportation are primarily on proposed pipelines still subject to regulatory approval. Amounts are due under these commitments over the next 24 years.

### b) Other

Other commitments primarily include Canadian Oil Sands' 36.74 per cent share of Syncrude's commitments for:

- natural gas and diesel deliveries in 2015 at floating market prices;
- tire purchases for 2015 through 2024;
- camp accommodations for 2015 through 2017; and
- capital expenditures in 2015.

## 21) Contingencies

Various suits and claims arising in the ordinary course of business are pending against Syncrude Canada. While the ultimate effect of such actions cannot be ascertained at this time, in the opinion of the Corporation's management and in consultation with its legal counsel, the possibility of an outflow of resources is remote. Syncrude Canada, as well as Canadian Oil Sands and the other Syncrude owners, also have claims pending against various parties, the outcomes of which are not yet determinable.

## 22) Guarantees

Canadian Oil Sands has posted performance standby letters of credit with the Province of Alberta which are renewed annually. The letters of credit guarantee to the Province of Alberta the obligations of Canadian Oil Sands' interest in future reclamation and closure of the Syncrude mines and plants (Note 11). The Province of Alberta can draw on the letters of credit if Syncrude fails to perform its reclamation and closure duties. The maximum potential amount of payments Canadian Oil Sands may be liable for pursuant to these letters of credit is $75 million.

## 23) Supplementary Information

### a) Change in Non-Cash Working Capital

| For the years ended December 31 *($ millions)* | 2014 | 2013 |
|---|---|---|
| Operating activities: | | |
| Accounts receivable | **$ 184** | $ (58) |
| Inventories | **(25)** | (26) |
| Prepaid expenses | **(1)** | 1 |
| Accounts payable and accrued liabilities ("AP") | **(299)** | 82 |
| Current taxes | **(276)** | 219 |
| Other | **14** | 16 |
| AP changes reclassified to investing activities | **42** | 2 |
| Change in operating non-cash working capital | **$ (361)** | $ 236 |
| Investing activities: | | |
| Accounts payable and accrued liabilities | **$ (42)** | $ (2) |
| Change in investing non-cash working capital | **$ (42)** | $ (2) |
| Change in total non-cash working capital | **$ (403)** | $ 234 |

### b) Income Taxes and Interest Paid

| For the years ended December 31 *($ millions)* | 2014 | 2013 |
|---|---|---|
| Income taxes paid | **$ 449** | $ 77 |
| Interest paid | **$ 117** | $ 126 |

Income taxes paid and the portion of interest costs that is expensed are included within cash from operating activities on the Consolidated Statements of Cash Flows. The portion of interest costs that is capitalized as property, plant and equipment is included within cash used in investing activities on the Consolidated Statements of Cash Flows.

### c) Major Customers

In connection with the marketing and sale of Canadian Oil Sands' own synthetic crude oil for the year ended December 31, 2014, the Corporation had two customers (2013 - three) which individually accounted for more than 10 per cent of consolidated sales. Sales to these customers in 2014 were approximately $1,083 million (2013 - $1,495 million). Concentration of sales is monitored regularly and, in management's assessment, the Corporation is not dependent upon these major customers.

### d) Geographical areas

| For the years ended December 31 *($ millions)* | 2014 | 2013 |
|---|---|---|
| Canada | **$ 3,492** | $ 3,715 |
| United States | **420** | 493 |
| Total Sales[1] | **$ 3,912** | $ 4,208 |

[1] *Sales are allocated to each country based on the location of delivery.*

### e) Cash Flow from Operations per Share

| For the years ended December 31 *($ millions)* | 2014 | 2013 |
|---|---|---|
| Cash flow from operations per Share, basic and diluted | **$ 2.28** | $ 2.78 |

Cash flow from operations per Share is calculated as cash flow from operations, which is cash from operating activities before changes in non-cash working capital, divided by the weighted-average number of outstanding Shares in the period.

## 24) Accounting Pronouncements Not Yet Adopted

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers,* which replaced several revenue recognition standards previously issued by the IASB. The new standard establishes principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. Application of the standard is mandatory for years beginning on or after January 1, 2017 with earlier application permitted. Canadian Oil Sands continues to assess the impact of this new standard.

**Canadian Oil Sands Limited**
Ryan Kubik
President & Chief Executive Officer

**Shares Listed - Symbol: COS**
Toronto Stock Exchange

**For further information:**
Siren Fisekci
Vice President, Investor & Corporate Relations
(403) 218-6228

Scott Arnold
Director, Investor & Corporate Relations
(403) 218-6206

Canadian Oil Sands Limited
2000 First Canadian Centre
350 - 7 Avenue S.W.
Calgary, Alberta T2P 3N9
Ph: (403) 218-6200
Fax: (403) 218-6201

invest@cdnoilsands.com

web site: **www.cdnoilsands.com**

# STATISTICAL SUMMARY

| ($ millions, except as indicated) | **2014** | 2013 | 2012[1] | 2011 | 2010[2] |
|---|---|---|---|---|---|
| **FINANCIAL** | | | | | |
| Sales, after crude oil purchases and transportation expense | **3,419** | 3,565 | 3,566 | 3,934 | 3,180 |
| Operating expenses | **1,686** | 1,494 | 1,505 | 1,501 | 1,387 |
| Development expenses[3] | **150** | 133 | 101 | 113 | 105 |
| Crown royalties | **221** | 174 | 202 | 307 | 306 |
| Administration | **25** | 30 | 26 | 25 | 20 |
| Insurance | **11** | 11 | 10 | 8 | 11 |
| Net finance expense | **47** | 44 | 56 | 46 | 82 |
| Depreciation and depletion | **514** | 478 | 403 | 381 | 429 |
| Foreign exchange (gain) loss | **134** | 88 | (25) | 22 | (60) |
| Tax expense (recovery) | **171** | 279 | 315 | 387 | (289) |
| Net income | **460** | 834 | 973 | 1,144 | 1,189 |
| Per Share, basic and diluted | **0.95** | 1.72 | 2.01 | 2.36 | 2.46 |
| Cash flow from operations[4] | **1,106** | 1,347 | 1,581 | 1,897 | 1,232 |
| Per Share[4] | **2.28** | 2.78 | 3.26 | 3.91 | 2.55 |
| Dividends | **678** | 678 | 654 | 533 | 896 |
| Per Share | **1.40** | 1.40 | 1.35 | 1.10 | 1.85 |
| Capital expenditures | **930** | 1,342 | 1,086 | 643 | 582 |
| **RESERVES** (billions of SCO bbls, net to COS) | | | | | |
| Proved reserves | **0.7** | 0.7 | 0.8 | 0.8 | 0.9 |
| Proved plus probable reserves | **1.6** | 1.7 | 1.7 | 1.8 | 1.8 |
| Contingent resources | **1.7** | 1.9 | 1.9 | 1.9 | 2.0 |
| Prospective resources | **0.4** | 0.6 | 0.6 | 0.6 | 0.6 |
| **OPERATING NETBACK** ($/bbl) | | | | | |
| Realized SCO selling price | **99.24** | 99.55 | 91.90 | 101.20 | 80.53 |
| Operating expenses | **48.86** | 41.75 | 38.91 | 38.80 | 35.42 |
| Crown royalties | **6.39** | 4.85 | 5.21 | 7.93 | 7.80 |
| Netback price | **43.99** | 52.95 | 47.78 | 54.47 | 37.31 |
| **FINANCIAL RATIOS** | | | | | |
| Net debt-to-cash flow from operations (times)[5] | **1.7** | 0.6 | 0.2 | 0.2 | 1.0 |
| Net debt-to-total net capitalization (%)[4] | **29** | 14 | 5 | 9 | 24 |
| Return on average productive capital employed (%)[5,6] | **10** | 18 | 20 | 25 | 25 |
| Return on average shareholders' equity (%)[5] | **10** | 18 | 22 | 29 | 33 |
| **TRADING DATA** | | | | | |
| Share price high | **24.68** | 21.93 | 25.19 | 33.94 | 33.05 |
| Share price low | **8.20** | 18.62 | 18.21 | 18.17 | 24.24 |
| Share price close | **10.42** | 19.98 | 20.17 | 23.25 | 26.45 |
| Trading volume (millions of Shares) | **476.3** | 403.9 | 402.1 | 567.1 | 412.7 |
| Number of Shares outstanding (in millions) | **484.6** | 484.6 | 484.6 | 484.5 | 484.4 |
| **VOLUME** | | | | | |
| COS average daily sales (bbls/d)[7] | **94,557** | 98,037 | 105,680 | 106,015 | 107,280 |
| COS total sales (mmbbls)[7] | **34.5** | 35.8 | 38.7 | 38.7 | 39.2 |
| Syncrude average daily production (bbls/d) | **258,057** | 267,022 | 286,505 | 288,372 | 293,288 |
| Syncrude total production (mmbbls) | **94.2** | 97.5 | 104.9 | 105.3 | 107.0 |

1 Operating expense, net finance expense, tax expense, net income, net income per Share, return on average productive capital employed and return on average shareholders' equity have been adjusted in 2012 to reflect the amendments to International Accounting Standards ("IAS") 19, Employee Benefits, which were adopted on January 1, 2013. Years prior to 2012 have not been adjusted.
2 Adjusted for International Financial Reporting Standards ("IFRS"). Note 26 to the 2011 annual audited consolidated financial statements discloses the impact of the transition to IFRS on the Corporation's reported financial position, income and cash flows.
3 Previously referred to as non-production expenses.
4 Additional GAAP measure as defined in the Additional GAAP and Non-GAAP Financial Measures Advisory.
5 Non-GAAP measure as defined in the Additional GAAP and Non-GAAP Financial Measures Advisory.
6 The calculation for this Non-GAAP measure was adjusted in 2013 and prior year amounts are restated to conform to the current year calculation.
7 The Corporation's sales volumes differ from its production volumes due to changes in inventory, which are primarily in-transit pipeline volumes.

For additional information regarding Additional GAAP and Non-GAAP financial measures, please see the Additional GAAP and Non-GAAP financial measures advisory in the 2014 Annual Report.

DESIGN: CRAIB DESIGN AND COMMUNICATIONS WWW.CRAIB.COM

Canadian Oil Sands

CDNOILSANDS.COM

Connect with us online and check out our blog at: http://blog.cdnoilsands.com